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INDONESIA: BARGAINING AND DEPENDENCY IN THE PETROLEUM AND TEXTILE INDUSTRIES

BY

© SMITA SWARUP

A THESIS SUBMITTED TO THE FACULTY OF GRADUATE STUDIES AND RESEARCH IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF DOCTOR OF PHILOSOPHY

DEPARTMENT OF POLITICAL SCIENCE

EDMONTON, ALBERTA
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15 December 1994
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Dedication

To my parents,
Rajni and Shanti Swarup.

Abstract

This study analyses state autonomy and the ability of Third World host states and local firms to erode the transnational corporations' three firm-specific assets - finance, technology, and markets. Utilising the regressive-dependency, dynamic-dependency, and bargaining "balance of power" perspectives, this study places the theoretical literature on state/transnational relations in historical context. This contextual relevance is brought out in an analysis of the Indonesian textile and petroleum industries from 1949 to the late 1980s.

The study finds that host states require strong institutions to increase their bargaining power with transnationals. Knowledge of the operational characteristics of the capitalist system and industry structure is an invaluable resource for the dependent state. Changing orientations within the state apparatus, international and domestic factors aid or hinder the erosion process at different historical junctures. The dependent state that starts from a regressive dependency position with respect to transnationals begins the process of climbing a learning curve to erode their power. It may succeed in undermining the original bargain with transnationals.

The level of technological dynamism and firm mobility in an industry determine the relative success with which host states and local firms can now overcome entry barriers. In Indonesia, the state remains partially dependent on the upstream petroleum transnationals' firm-specific services. In the standardised segment of the textile industry local firms can displace transnationals when a decade ago the transnational connection was essential to their emergence as industrial entrepreneurs.

In the oil supply and services sector and the garment industry, the technological dynamism and firm mobility of transnationals keep to varying degrees local firms and the host state dependent on transnationals in varying degrees depending on the technical and marketing sophistication of local firms and their ability to raise finances independently. The study concludes that while the host state and local firms may be partially dependent, bargaining continues to be viable.

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Many people helped me to bring this project to fruition. I thank my mother, Rajni Swarup, for urging me to dare. My older brother, Swapn Swarup, nurtured my love for reading. My father, Shanti Swarup, in whose footsteps I have followed as a Political Scientist, taught me to value history, to be sceptical and to think critically. My teachers and mentors Professor Larry Pratt, Professor Fred Judson, Professor Thomas Keating, and Professor Jeremy Paltiel challenged me to sharpen these faculties. My supervisor, Professor L.R. Pratt constantly stirred me to surpass myself. Professor Fred Judson consistently steered my course. Without his guidance and encouragement, this thesis would not have seen the light of day. I am grateful to my external examiners, Professor Gordon Laxer at the University of Alberta and Professor Jeffrey Steeves at the University of Saskachewan for reading my thesis.

A dissertation fellowship from the Faculty of Graduate Studies and Research enabled me to embark on my Indonesian adventure. The International Centre and Student Financial Aid at the University of Alberta gave me emergency loans and bursaries over the years. I am particularly grateful to Sharon Shultz at the International Centre for her kind patience.

I had mentors in Indonesia. I am particularly grateful to Ir. Wijarso and Ibu Ann Soekatrie without whom my Indonesian research trip would have been futile. My interviewees provided the empirical information that lends much of the detailed richness to this thesis. I name these individuals in the bibliography. In the text, as I promised them, they have remained anonymous unless they consented otherwise.

I am deeply indebted to my partner, John Gerdes. John encouraged me when I was in doubt, reminded me to remain focussed, believed in my abilities, and gave me material and non-material support. He admirably endured a relationship with an often disgruntled and preoccupied Ph.D student.

My friends, my Canadian family away from home, assisted me in countless and variegated ways. So also did I find a similar family in Indonesia. It was the constant encouragement, love and support of my friends that gave me the tenacity to carry on this project when it seemed almost intolerable to carry it on for yet another day. To name all my supporters would require several pages. To name only a few would offend those I would leave out, to whom I am also deeply indebted. I therefore thank them all and hope that they will know that this gratitude is meant for them. My feline comrade, Ming, stayed up with me during the long hours that I spent before the computer.

Over the years, Audrey Bell-Hiller, Kim Nicholson, Alice Lau and Pam Ouimet and Glenda Golish, Sharon Moroschan, in the Department of Political Science, amicably streamlined the bureaucratic process and assisted me in finalising my dissertation. I am grateful to Verda Norlin and Monika Hoffart at the Faculty of Graduate Graduate Studies and Research for combining efficiency with warmth.

Indonesia: Bargaining and Dependency in the Petroleum and Textile Industries

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Introduction

History matters. Almost every structural marxist in the past three decades has imbibed and adopted the methodological position embedded in Marx's Eighteenth Brumaire of Louis Bonaparte, that history is made within the parameters of constraints.[1] Human beings act but they are also bound. Volitional choices can and do become constraints for humans and institutions. States, private and public local entrepreneurs, and transnationals are limited by their own past choices and those of other agents. They are limited by past history and by the nature and structure of the industry concerned. But these actors also represent structures of power. The state, with its sovereign territorial status and a monopoly over the legitimate use of force over civil society, and transnationals with their control over finance, capital, and technology, are armed with formidable resources. Domestic firms are potent to the extent that they can influence government policy and replace transnationals. It is the clash and the consensus among these actors that comprise the stuff of this study.

The central concepts that inform this study are "erosion" and "autonomy". This study examines how host states and local entrepreneurs in industrialising countries meet the challenge of transnational corporate power. It asks whether Third World states and local firms can successfully erode the transnationals' firm-specific advantages and thus their immense power. Autonomy is the ability to maximise choices with the minimum of external constraints. Its converse is dependency.

---

[1] Karl Marx, The Eighteenth Brumaire of Louis Bonaparte in K. Marx and F. Engels, Selected Works 2 vols. (Moscow: Foreign Language Publishing House, 1962).

Using the Indonesian oil and textile industries as case studies, this study repeats a question posed by Dennis Encarnation: why have some countries triumphantly uprooted transnationals in one industry after another while other countries have failed in this endeavour?[2] But the question is also framed in another way: why do host states pursue an aggressive strategy to control transnationals in one sector of the economy while they pursue a relatively laissez-faire policy at the same historical juncture? Consequently, two industries were chosen: the oil and textile industries. This difference in strategies in and of itself indicates that the state is not and cannot be treated as a monolithic entity. A manufacturing and natural resource industry were chosen to compare corporate and state strategies because scholars have achieved different results with regard to erosion and autonomy in natural resource and manufacturing industries, differences that are detailed in the next chapter.

This work combines empiricism with an eclectic use of a growing body of theoretical work that seeks to explain the relations between transnationals and industrialising countries. Where it is valid one or a combination of three approaches are used, that for convenience can be called the regressive dependency, dynamic dependency and the bargaining "balance of power" perspectives. The latter two perspectives share many similarities, so that the distinction between the two models is often blurred. The regressive dependency perspective is represented in the work of Andre Gunder Frank and

---

[2] Dennis Encarnation, Dislodging the Multinationals (Princeton: Princeton University Press, 1989).

Paul Baran.[3] Fernando Cardoso and Enzo Faletto and Peter Evans began the dynamic dependency tradition.[4] The bargaining "balance of power" perspective can be found in the work of Theodore Moran and Raymond Vernon.[5]

The regressive dependency perspective laments the weakness of Third World states and their external conditioning by the global capitalist system organised by transnationals and advanced capitalist states. Dynamic dependency emphasises that states and their societies are historically structured and dynamically changing with varying degrees of vulnerability to the winds of external and internal change. While states may be in a continuous state of dependency, they are also able to increase their options for autonomous action. The bargaining "balance of power" model posits that over time host governments can successfully increase their control over industries - natural resource and manufacturing - with varying degrees of success depending on the nature of the project and industry, and on changing international and domestic factors in the industry. Strong state institutions, a knowledgeable bureaucracy, and in industries where the state is primarily a regulator, a growing entrepreneurial class, are key ingredients for increased state autonomy in all three perspectives. All three perspectives see the state as constrained by its capitalist nature.

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[3] See for instance, Andre Gunder Frank, Dependent Accumulation and Underdevelopment (New York: Monthly Review Press, 1978); Paul Baran, The Political Economy of Growth (New York: Monthly Review Press, 1968).

[4] Fernando H. Cardoso and Enzo Faletto, Dependency and Development in Latin America (Berkeley: Berkeley Unviersity Press, 1979); Peter B. Evans, Dependent Development: The Alliance of Multinational, State, and Local Capital in Brazil (Princeton: Princeton University Press, 1979).

[5] Theodore H. Moran, Multinational Corporations and the Politics of Dependence: Copper In Chile (Princeton: Princeton University Press, 1974); Raymond Vernon, Sovereignty at Bay: The Multinational Spread of U.S. Enterprises, (New York: Basic Books, 1971).

This study tests existing hypotheses. It brings two additions to the growing body of knowledge dealing with industry-specific historical studies on host government/transnational/local capital relations: a focus on Indonesia, a vast sprawling archipelago, and a comparison of state and transnational strategies in a natural resource industry, petroleum, and a manufacturing industry, textiles, both of which have segmental divisions that allow internal comparisons.

When this work was conceived nine years ago, there was little political economy work on Indonesia. Now there is more. Andrew MacIntyre has devoted a chapter to the rise of industry associations and the increasing penetration of the state by society in Indonesia's textile industry, concentrating on cotton import textile policy from 1986-1988.[6] But MacIntyre does not analyse alliance formation between different fractions of capital, distinguish the nature and interests of transnational capital from their domestic counterparts, or analyse bargaining between the state, transnationals, and local capital in the textile industry. Nor does he adopt a historical perspective. These are key ingredients of this study.

This study was in process when two studies were completed on Indonesia's petroleum industry. Khong Cho Oon employs a legalistic and an economistic approach to bring out the differences between the legalities and the realities of the Indonesian state's control over the oil industry.[7] Jean Bush Aden's comprehensive historical and descriptive study on petroleum politics from 1949-1980 focuses on domestic oil politics in the context of the existence of transnational capital.[8]

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[6] A.J. MacIntyre, Business and Politics in Indonesia (Sydney: Allen and Unwin, 1991).

For Aden the personal aspirations of Indonesia's power brokers and concentration of power are the core factors that gave the Indonesian state the resources to bargain assertively with the oil transnationals from 1963 to 1976. From Indonesian evidence after 1976, Aden generalises that excessive centralisation and the absence of intermediaries between the state and transnationals reduced the state's bargaining power. While recognising that the concentration of power can aid or hinder administrative efficacy and that power brokerage is significant in policy outcomes, this study will show the more complex interaction of internal and external variables involved in policy decisions, bargaining outcomes, and the state's ability to erode the transnationals' firm-specific assets in the Indonesian oil industry.

General studies on foreign investment in Indonesia ignore the state's continued partial dependency on petroleum transnationals.[9] With primary source material and a fresh theoretical approach that combines the regressive dependency, bargaining "balance of power" and dynamic dependency perspectives in historical context, this study adds new insights, confirms, builds upon, or invalidates aspects of MacIntyre's, Aden's and Oon's work.

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[7] Khong Cho Oon, The Politics of Oil in Indonesia: Foreign Company-Host Government Relations (Cambridge: Cambridge University Press, 1986).

[8] Jean Bush Aden, "Oil and Politics in Indonesia:1945-1980" 2 vols. (Ph.D diss., Cornell University, 1988), Chap. 1.

[9] See for instance Hall Hill, Foreign Investment and Industrialisation in Indonesia (Singapore: Oxford University Press, 1988); Richard Robison, Indonesia: The Rise of Capital (North Sydney: Allen & Unwin, 1986); Thee Kian Wie, "Japanese Direct Investment in Indonesian Manufacturing," Bulletin of Indonesian Economic Studies 20 (August 1984), 90-106.

The interview method, supported by a thorough investigation of primary source materials - contracts, government/corporate communications, and legislation - provide the buttresses for this study. A critical research strategy involved asking each respondent to provide further sources of information - individuals and documents - to achieve a deeper understanding of the political and economic ramifications of bargaining encounters, state and corporate motives, perceptions and objectives over time. The study process comprised two stages. The first stage included learning about the international and domestic technical and legal nature of the industries. In the second step, information gleaned in the first stage was tied to the politics and economics of the two industries. The research and writing process incorporated a dialectical interaction between hypotheses and empirical facts.

In chapter 1, I introduce the theoretical body of literature on the subject of transnational/host country relations with the aim of locating its historical relevance to specific historical periods in Indonesian history. In chapter 2, I step back into history to show the impact of colonialism on the structure of the Indonesian economy, inhibiting the development of an entrepreneurial class, encouraging the development of a rentier ethic in the Indonesian economic fabric, and establishing the dominance of transnational capital in the natural resource and agricultural sectors.

Chapters 3-9 analyse the post-independence period in the oil industry. From 1949-1963, the dependencia model fit, as is shown in chapter 3. But Chapter 3 also examines the first rudimentary attempts by the Indonesian state to challenge transnational control. Concentrating on the late Old Order and the early New Order years, Chapter 4 details the growth of institutions created to bargain with and regulate transnationals, the attempt of transnationals to utilise internal state fragmentation to their advantage, and the state's ability to utilise the opportunities provided by the external environment and inter-capitalist rivalry to begin the erosion process. Focusing on trends that began in the late 1960s and continued into the 1970s, Chapter 5 shows the areas in which and the processes by which the dependent state undermined the transnationals' control over the industry while recognising the limits of its continued dependence on their firm-specific assets. Chapter 6 discusses oil politics from 1973 to 1978. It highlights how intra-bureaucratic conflict prevented the state from maximising its gains from the oil industry in the early 1970s, years which were hailed as a period of triumph and confrontation between transnationals and host states. Concentrating on the 1979 to 1983 period, Chapter 7 demonstrates how a powerful transnational neutralises an increasingly dirigiste bureaucracy by utilising its trump cards - technology, finance, and to a lesser extent marketing, and by exploiting conflicting interepretations of the general interest in the state apparatus. In chapter 8 there is a discussion of host state/transnational bargaining in the era of benign nationalism and growing transnational ascendancy from 1983 to 1989. Chapter 9 discusses the prospects for local firms to ascend the learning curve and for state bargaining in the high-tech, mobile oil supply industry.

Chapters 10-12 cover the post-independence period in the textile industry. Chapter 10 links the conclusions in chapter 2 to explain the historical conditions that made foreign investment essential to the Indonesian industrialisation drive. It also discusses the motivations for transnational entry and the laissez-faire approach that a state in a position of extreme dependency adopts towards transnationals. Chapter 11 highlights the adoption of a dirigiste state policy towards the textile transnationals in 1979 coinciding with the emergence of an entrepreneurial class, to undermine the transnationals' oligopolistic control over the industry by introducing foreign and domestic competition. It also shows how fractions of transnational and domestic capital forge alliances and capture specific sections of the state apparatus to steer policy in a direction that favours their interests. Chapter 12 focuses on changing state orientations and strategies as the state moves from an import-substitution strategy to an export-oriented one. It shows that in the garment industry, which shares the characteristics of high-tech manufacturing industries, eroding the firm-specific assets of transnationals is more difficult but not insurmountable. Chapters 11 and 12 cover the post-1979 to 1988 period.

Chapter 1

Theory and Historical Origins

This is a study about the ability of the state and local capital to erode the power and dominance of transnational corporations. It analyses the responses of the Indonesian state, local public and/or private capital, and transnationals to the changing international and domestic environment and to the constraints imposed by the interests and power that they bring to the alliances that they forge at specific historical junctures. State autonomy is central to the analysis. In this chapter I have first outlined some broad features of the three major sets of actors in a general way to show their relative importance and power. I have then discussed the three major intellectual discourses that have informed the debate on the role of transnational corporations. Placed in historical context, these discourses are relevant to understanding the specific Indonesian case and the role of transnationals in developing countries in general. But if they are taken out of their historical context and debated to explain another historical era, they lose their relevance.

The regressive dependency perspective best explains the era of transnational domination which varies depending on the specific historical case under study. In the case of Indonesia, this period would last from 1949 until 1963 for the oil industry. For the textile industry it is shorter - 1967 to 1974. During these periods the Indonesian state was unable or unwilling to bargain with the transnationals. A combination of the dynamic dependency and the balance of power models explains the Indonesian state's relationship with foreign capital in the oil industry beginning in 1963 and in the textile industry beginning in 1974. In section VI, I have discussed the recurrent debate about the prospects for state bargaining in an era of transnational ascendancy in the 1980s and 1990s; this provides a background for the discussion of state/transnational bargaining in Indonesia's oil and textile industries during this period.

Section I

The Transnationals

Political economists are demanding that it is time to bring the transnational back into mainstream political economy.[1] For over a century, transnationals have furnished direct and new inflows of capital to the former colonial and newly industrialising economies. Transnationals are important actors in the world economy. They straddle national boundaries. The sales of the biggest transnationals surpass the gross national product of many countries. In 1988, the largest 600 industrial companies accounted for between one-fifth and one-fourth of value-added in the production of goods in the world's market economies.[2] The sales of the largest 56 transnationals range between $10 billion and $100 billion.[3] In the 1990s these corporations are expected to become more, not less significant in global production, trade, and the dissemination of knowledge. An increasing proportion of trade, technology transfers, and private financial flows is expected to be linked to international production and transnational corporations.[4]

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[1] Lorraine Eden, "Bringing the Firm Back in: Multinationals in IPE," Millennium Journal of International Studies 20 (Summer 1991), 197-224.

[2] United Nations, Centre on Transnational Corporations, Transnational Corporations in World Development: Trends and Prospects (New York: United Nations, 1988), 16.

[3] Ibid.

Transnational corporations undertake most foreign direct investment and a substantial share of trade, technology transfers, and private financial flows. To a great extent transnationals conduct these activities and maximise their profits on an intra-firm basis in response to their strategic interests - their global growth and profitability.[5] In the mid-1980s, 80 to 90 percent of the financial transactions from industrialising countries to the Federal Republic of Germany and the United States involved payments from subsidiaries in industrialising countries to their parent firms.[6]

Transnational corporations are also the prime sources of technological innovations and transfers from the industrialised to the industrialising countries. Transnationals derive much of their power and profits from their ability to create innovative products that their rivals or local developing country firms cannot duplicate. They guard these innovations closely, usually at the research and development centre housed in their parent's headquarters. In the view of one analyst, "As long as transnationals are free to make that choice, the industrialisation of the periphery will remain partial. Facilities for the production of new knowledge will not be located there. New technology will continue to be generated by the centre countries and later assimilated by the periphery."[7]

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[4] United Nations, Centre on Transnational Corporations, World Investment Report 1991: The Triad in Foreign Direct Investment (New York: United Nations, 1991), 81.

[5] Ibid.

[6] Ibid., 76.

[7] Peter B. Evans, Dependent Development: The Alliance of Multinational, State, and Local Capital in Brazil (Princeton, N.J.: Princeton University Press, 1979), 37.

Their sheer size, power and global rationality, which subordinates local and national interests, have made transnationals the subject of much criticism, hatred, and fear, especially in developing countries. Although this feeling is now muted, until the early 1970s the attack on transnationals in the industrialising countries stemmed from a heightened sense of anti-colonial economic and political nationalism. Industrialising countries viewed the control exercised by transnationals as economic colonialism which undermined their sovereign status and prevented them from defining the terms and conditions of their own destiny.

Transnationals were seen, indeed they often projected themselves, as envoys of their governments and their governments were seen as corporate diplomats; by their critics both were seen as involved in a symbiotic relationship to exploit the industrialising world. It was not rare for transnationals to influence the decision-making of their host states. And, sometimes they were directly involved in overthrowing governments with the aid of their home governments as in Iran in 1953 and Chile in 1973. The oil transnationals, which controlled an industry on the "commanding heights of the economy", were particularly suspect.[8]

Transnationals were seen to take decisions that benefitted their shareholders and consumers in the industrialised countries; they were criticised for not transferring technology or for transferring inappropriate technology; for importing too many components and thus increasing capital outflows; for stunting competition through oligopolistic distribution and pricing strategies; for preventing the emergence of a domestic entrepreneurial class; for hiring foreigners to the detriment of nationals; for creating unhealthy and unnecessary consumption habits among industrialising country elites; for signing joint ventures in which domestic entrepreneurs were subordinated and had to take care of the global interests of the foreign partner rather than the national interest; and so on.

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[8] See for instance, Louis Turner, Oil Companies in the International System (London: George Allen & Unwin, 1983), chaps. 4-5.

Yet despite all this criticism, the absolute volumes of direct investment to developing countries continued to grow. During the 1960s foreign direct investment by transnationals accounted for more than half of all private capital inflows from industrial to developing countries.[9]

The question that this study addresses is: can and do industrialising country host governments and private firms erode and undermine the power of these gigantic entities, the transnationals? Can host governments and local firms persuade transnationals to give priority to local concerns or at least make their strategic decisions coincide with local and national interests? In other words, what are the bargaining parameters for states and local capital in their interaction with transnationals?

The State

In the 1980s, after a periodic eclipse, the state re-emerged at the centre of political analysis, with a concomitant emphasis on state autonomy.[10] The notion of state autonomy is important, because it is a measure of the extent to which the state has the capacity for independent action, in the pursuit of its own preferences. It is based on the premise "that [state autonomy] is any kind of independent leadership reflected in the actions of the state."[11] It is the means that the state uses "to influence the distribution of power, either among states or among groups within the state."[12] Ultimately, it is the degree to which a state is in a position to take decisions independently of external pressures - domestic, international, and global - that is a measure of its autonomy. Of course, the state may not exercise its autonomy. Of the French state Zysman writes, "it has the structural potential for autonomous action but structure does not determine how or whether that potential is used. A political explanation will always be required to explain the direction of state activity."[13]

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[9] David J. Goldsbrough, "Investment Trends and Prospects: The Link with Bank Lending," in Investing in Development: New Roles for Private Capital? ed. T.H. Moran (Washington, D.C.: Overseas Development Council, 1986), 174.

International political scientists have emphasised the internationalisation of domestic politics while comparativists have stressed the domestication of international politics. While there has been an increasing recognition of the interaction of the two levels, the difference in emphasis is often evident. Scholars such as Zysman argue that all responses to the state's external pressures are conditioned by domestic institutional arrangements.[14] For international relations theorists, the domestic structure is an independent or intervening variable at times an irrelevant, one.[15] Since political processes cross the domestic/external divide, their analytical separation and assumed autonomy are artificial.

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[10] See Peter Evans, Diertrich Reuschemeyer and Theda Skocpol, " On the Road to a More Adequate Understanding of the State," in Bringing the State Back In ed. Peter Evans, Diertrich Reuschemeyer and Theda Skocpol (Cambridge: Cambridge University Press, 1985) 347-65. See also Stephen Krasner, Defending the National Interest (Princeton: Princeton University Press, 1978).

[11] Max Weber, "Politics as a Vocation," in From Max Weber: Essays in Sociology Gerth and Mills eds. (Oxford: Oxford University Press, 1958), 77.

[12] Ibid.

[13] John Zysman, "The French State in the International Economy," in Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States ed. Peter J. Katzenstein (Wisconsin: The University of Wisconsin Press, 1978), 267.

As an abstraction state autonomy derives from the exclusive character of the state - "the state in action" is insulated from all groups outside it. But because autonomy is never complete, state autonomy is always relative. Gerschenkron cautions the analyst from making assumptions about the state's absolute autonomy. "The permeability of state authority is clear. State autonomy pre-supposes trade-offs, agreements, alliances. No one actor is likely to be vast enough to obtain simply its policy preferences. It will therefore have to form a political coalition to win."[16]

The coalition strong enough to win, often based on convergent interests, enhances the capacity of the state to achieve its desired objectives. The state is incapable of achieving its objectives on its own. It is usually an alliance with the strongest partners which is the basis of the political coalition to win. For instance, while the Korean, Taiwanese, French, Japanese, Brazilian states were strong and were insulated from societal pressures of the populist variety, they could not be completely insulated from social pressures because the state was allied with the subordinate capitalist class. Gerschenkron argues that even in Nazi Germany the state - to fulfill its own objectives - gave the capitalist class some power and autonomy despite its potential ability to overthrow the regime.[17]

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[14] Ibid.

[15] See for instance Kenneth Waltz, "Theory of International Relations," in Handbook of Political Science: International Relations ed. Fred Greenstein and Nelson Polsby vol.8 (Menlo Park: Addison-Wesley, 1975), 1-86.

[16] Alexander Gerschenkron, Economic Backwardness in Historical Perspective (Cambridge, Mass: Belknap Press of Harvard University Press, 1962), 6.

Relative state autonomy occurs in a relational and interactional environment. Interaction takes place at three levels: a) between the state and different groups, institutions, and states operating within each distinct sphere of state action; b) actors within each dimension interact with other actors either independently or with the state as the directing or intervening actor; c) actors are involved in symbiotic/conflictual relationships. There is a continual struggle in which state actors compete or ally themselves with other actors to enhance their power.

A lengthy discussion of the various approaches to the state is beyond the scope of this study. The aim is to understand the Indonesian state in particular, and the industrialising country state in general. The structural-marxist notion of the state as relatively autonomous in specific instances, exemplified in the work of Poulantzas, is useful for this analysis.[18] It recognises that the relatively autonomous state is involved in a dependency situation, as are other actors, groups, and classes in society.

The structural-marxist position emphasises that the state must be independent of the particular interests of individual capitals to promote the general interests of capital. But, the state also has interests of its own: to ensure its survival; to promote capital accumulation; and to expand its own revenue base. These interests create conflicts between the state and particular capitals or fractions of capitals. It is here that there is room for bargaining.

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[17] Ibid.

[18] Nicos Poulantzas, "The Capitalist State: A reply to Miliband and Laclau," New Left Review 95 (January-February 1976), 63-83

Poulantzas emphasises that the capitalist state is relatively autonomous because the capitalist mode of production is competitive. The state stands above the particular interests of individual capitalists or fractions of capital who are involved in a competitive battle. The state must perform this role to safeguard unity within the body politic and its own existence. According to Poulantzas, the "relatively" autonomous state moves to restrain the competitive strife within the capitalist class over the allocation of surplus value.[19]

The conception of the relatively autonomous state allows the analyst to look at the state in the following manner: the state can establish an alliance with foreign and domestic corporations while it can simultaneously be involved in conflictual relationships with those allies. It sometimes takes actions that are favourable to transnationals. At other times, it implements policies that are detrimental to their interests. The dependent state has a "dual and contradictory role"[20] and is not and cannot be unfailingly nationalist or constantly comprador.[21] The role of the state in presenting the interests of capital as the national interest is rendered particularly problematic where a large part of that capital is foreign-owned.[22]

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[19] D. Gold, C Lo, and E. Wright, "Recent Developments in Marxist Theories of the Capitalist State," Monthly Review (October-November 1975), 37.

[20] Guillermo O'Donnell, Modernization and Bureaucratic Authoritarianism: Studies in South American Politics (Berkeley: Institute for International Studies, University of California, 1973).

[21] Evans, Dependent Development, 214-216.

The relatively autonomous state cannot construct policies that undermine the essential processes of capital accumulation. While the state intervenes in the production process through state enterprises and joint ventures, it must not threaten the interests of the private sector. It must attract foreign investors. It must not undermine domestic entrepreneurs. It must promote local capital accumulation but not at the expense of foreign capital.[23]

The state is essentially a structure of power. Although it must make trade-offs and alliances with the powerful forces that will keep it in power, the state does not become a passive actor in the alliance. It seeks to become the stronger partner and to advance its interests even further by bargaining with its allies. In its own interests, it also seeks to reduce its dependence on its stronger allies, incumbent foreign capitalists, by seeking temporary or permanent allies outside the triple alliance. These allies might include international monetary institutions, foreign buyers, or foreign governments.

The state has a vested interest in capital accumulation. In the first place, the state's decision to ally itself with foreign capital is to expand its tax base. But that is not always enough. Particularly in natural resource industries, where the returns can be extremely high, the state will also seek to maximise those revenues. It will seek to become the senior partner in the alliance. But in seeking to achieve this position, it must create strong structures, such as state enterprises, within the state apparatus to bargain with foreign capital. Herein lies another pitfall. It must delegate some of its powers to these state structures or institutions, and thus part with some of its autonomy.

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[22] Rhys Jenkins, Transnational Corporations and Uneven Development: The Internationalisation of Capital and the Third World (London: Methuen, 1987), 169-170.

[23] Rhys Jenkins, Transnational Corporations and Industrial Transformation in Latin America (London: Macmillan, 1984), 234.

As long as the domestic entrepreneurial class is weak and is largely dependent on the state, the state elite may ignore or marginalise it. But there is an inner contradiction in the state's relationship with the domestic entrepreneurial class. It must enable it to become strong and therefore a more formidable ally against transnationals, one which will eventually influence its decision-making and restrict its ability to make independent decisions. As Bardhan notes in the case of India, with its powerful state enterprises and local capitalists, "While the state elite from its commanding heights formulated goals and pointed policy directions, neither at the behest of nor on behalf of the property classes (it) could not ignore the constraints on the framework of policy actions and certainly on their effective implementation posed by the articulated interests of those classes."[24] This is because the state decision-makers recognise that an extreme dependence on foreign allies is likely to be a tenuous and an unpopular one in the medium to long run.

Public and Private Capital

State enterprises have played a significant role in the economic development of late industrialising countries because of a weak entrepreneurial class and\or because of a weak liberal tradition.[25] In these countries, the state has also been active in those sectors that constitute "the commanding heights of the economy" and are classified as patrimonial property. In many industrialising countries, the state actively established local institutions - regulatory agencies, industrial enterprises and financial organisations.[26]

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[24] Pranab Bardhan, The Political Economy of Development in India (Oxford: Blackwell, 1984), 38.

[25] Gerschenkron, Backwardness, see esp. 6, 123, 354. Also see Zysman, "The French State," 264; Evans, Dependent Development, 86-90.

State enterprises in developing countries were created to perform certain tasks.[27] First, they were established to enhance the state's bargaining power with respect to transnationals and to achieve national control of strategic industries that occupied the "commanding heights of the economy".[28] Second, they were created to challenge the oligopolistic domination of transnationals and when possible to displace them. Third, if they could not replace them, then state-owned enterprises were to monitor the transnationals' activities while pursuing joint-maximisation strategies as their partners. Fourth, state enterprises were to maximise the state's rents by eroding the transnationals' internalised firm-specific advantages through "national control" of their operations. To achieve this goal, host governments aspired to monitor the transnationals' operations to obtain greater access to information and to participate in decisions regarding payments for technology transfer and management fees, pricing of output and intra-company trade, the reinvestment and repatriation of profits and capital. Fifth, state enterprises were expected to create the general conditions for capitalist accumulation by constructing the infra-structure required by the industry. Sixth, they were to fulfill specific national goals that transnationals were unwilling to perform because they found them unprofitable. Seventh, they were to conduct any other business that was defined as the "national interest" at any particular historical juncture. For this, the state had to concede some of its autonomy to its state enterprises. And then, state enterprises often begin to develop interests of their own and to challenge the state itself. Then, the question of managing these state enterprises often becomes a Herculean task for the state.[29]

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[26] Dennis J. Encarnation and Louis T. Wells Jr., "Evaluating Foreign Investment," in Investing in Development: New Roles for Private Capital? ed. T.H. Moran. (Washington, D.C.: Overseas Development Council, 1986), 61-85.

[27] See for instance Raymond Vernon, "Linking Managers with Ministers: Dilemmas of the State-Owned Enterprise," Journal of Policy Analysis and Management 4 (1984), 39-55; Raymond Vernon and Yair Aharoni, eds., State-Owned Enterprise in Western Europe (London: Croom Helm, 1981).

[28] Vernon, "Linking Managers," 40.

"The 'national industrial bourgeoisie' is the stepchild of imperialism, never completely abandoned but never given a full opportunity to develop."[30] When transnational capital first came to dominate an industrialising economy in manufacturing, the national capitalist class in many developing countries was non-existent or extremely weak. Consequently, even where industrialisation followed imperialism, the domestic capitalist class did not play a revolutionary or hegemonic role.[31] It had to accept a subordinate position to foreign capital in the industrialisation project.

Although local capital is subordinate to transnational capital, it does not necessarily disappear. Indeed, in some industries it may displace foreign capital. Small local capital involved in handicraft industries may perish at the hands of both foreign and domestic capital in the modern sector. Large local capital may not be able to overcome its dependency on the transnational corporations in industries where there are rapid technological and marketing innovations. Local capital may form subordinate alliances with transnational corporations but this does not mean that its interests always coincide with those of the transnationals. "The local bourgeoisie cannot afford to relinquish nationalism even if international capital has become its principal ally."[32]

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[29] Ibid.

[30] Evans, Dependent Development, 39.

[31] Fernando Henrique Cardoso and Enzo Faletto, Dependencia e Desenvolvimento na America Latina: Ensaio de Interpretacao Sociologica (Rio de Janeiro: Editora Zahar, 1973), 93 cited in Evans, Dependent Development, 39.

Section II

Until the advent of dependencia perspectives[33] on the academic scene, in the post World War II period, modernisation perspectives[34] grew in the fertile ground of American universities, funded by government agencies and private foundations, explaining the dismal condition of Third World countries and their prospects for development. Scholars placed the advanced industrialised countries on one extreme, the modernity end of the continuum. Third World countries stood on the tradition and backwardness end of the continuum. Stages of development(modernity) were identified, and characteristics of modern and traditional societies were catalogued. Now a framework had been readied for Third World planners to implement. Diffusion was central to the modernisation perspective: capital and technology would be diffused through foreign private and public capital while the cultural values of democracy and entrepreneurship would be disseminated through education and the media. [35]

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[32] Evans, Dependent Development, 40.

[33] I use the terms persuasions, perspectives, world-views, paradigms interchangeably. These allow for differences while there is a general agreement on certain basic values. I avoid using the term theory since it denotes rigourous and precise agreement among the scholars of each persuasion which in my mind is lacking in the various perspectives on development.

[34] The most popular of these writings include the economic writings of W.W Rostow, The Stages of Economic Growth: A Non-Communist Manifesto (Cambridge: Cambridge University Press, 1971); Bert F. Hoselitz, Sociological Aspects of Economic Growth (Glencoe, Il.: Free Press, 1960). Political scientists of this genre include Gabriel A. Almond and James S. Coleman ed. The Politics of Developing Areas (Princeton, N.J.: Princeton University Press, 1960) and A. Dankwart Rustow, A World of Nations: Problems of Political Modernization (Washington, D.C.: The Brookings Institution, 1967). Sociologists in this persuasion include Daniel Lerner, The Passing of Traditional Society: Modernizing the Middle East (New York: Free Press, 1964) and Alex Inkeles, "Making Men Modern: On the Causes and Consequences of Individual Change in Six Countries," American Journal of Sociology 75 (September 1969), 205-225.

Intellectual patterns matched history. By the mid-1960s, modernisation theory was scathingly attacked by Latin American, Asian and African academics.[36] The prophesies of modernisation theorists had been falsified as Latin American growth sputtered despite massive inflows of foreign private and public capital. The dependencia perspective grew out of this historical reality, a reality that modernisation theory had failed to address. At this historical juncture the dependency perspective, which took the regressive or stagnationist form, explained the reality in many third world countries quite nicely, although its futurist prognostications were erroneous.

The dependency perspective was based on some fundamental convictions: dependencia was a world-wide and historical phenomenon; third world countries were viewed as essential components of a single historical process, capitalist globalisation; work was apportioned between central and peripheral areas in an expanding world capitalist system which has a single indivisible logic; all capitalist countries were integrated into this system; while the development of the peripheral countries was geared towards the needs of the central countries, the development of the central countries was focused on their internal requirements; consequently, the latter derived the greatest benefits from the process of globalisation.

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[35] Harry G. Johnson, "The Efficiency and Welfare Implications of the International Corporation," in The International Corporation ed. Charles P. Kindleberger (Cambridge: M.I.T. Press, 1970), 35-56.

[36] For a non-dependency critique of these growth models see Gunnar Myrdal, Asian Drama:An Inquiry into the Poverty of Nations (Harmondsworth: Penguin Books, 1971).

The dependency perspective partially grew out of a mercantilist-realist and economic nationalist bias which rested on the ECLA model that national development based on import-substitution industrialisation and self-propelling development was a valued goal for third world states.[37] Nationalist leaders in many countries including Indonesia paid lip-service to it in the immediate years after independence. India's leaders, as Encarnation has shown, implemented this dream.[38] The nation-state thus became one of its primary units of analysis. Dependency's other unit of analysis was social class, for the dependency perspective's main concern was with the impact of capitalism on social, political, and economic fabric of the developing country.[39]

The Monthly Review school developed the most notable critique of transnationals. Its most renowned members included Baran, Sweezy, O'Connor and Magdoff and non-marxist scholars such as Girvan, Frank, and Amin.[40] They saw transnationals as major obstacles to third world development which could only be achieved through socialist revolutions. This particular school originated in the early twentieth century classical marxist and non-marxist studies of imperialism best represented in the works of Lenin, Bukharin, Hobson, Hilferding, and Rosa Luxemburg.[41] They linked oligopolistic industry to the export of capital and imperialism. For Lenin, imperialism's parasitic character prevented it from fulfilling Marx's progressive vision for the colonies. He deduced its parasitic nature from the oligopolistic character of firms which in his view produced stagnation, decay, and technical inertia.

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[37] Under Raul Prebisch's guidance the ECLA had disputed the neo-classical notions of economic development that rationalised the comparative advantages that these countries derived from continued agricultural and mineral production. Raul Presbisch, The Economic Development of Latin America and Its Principal Problems (New York: United Nations, 1950).

[38] Dennis J.Encarnation, Dislodging Multinationals: India's Strategy in Comparative Perspective (Ithaca and London: Cornell University Press, 1989), 14.

[39] Gary Gereffi, The Pharmaceutical Industry and Dependency in the Third World (Princeton: Princeton University Press, 1983), 12.

[40] Samir Amin, Imperialism and Unequal Development (New York: Monthly Review Press, 1977); Paul Baran, The Political Economy of Growth (Harmondsworth: Penguin, 1973); Paul Baran and Paul Sweezy, Monopoly Capital: An Essay on the American Economic and Social Order (Harmondsworth: Penguin, 1966); Andre Gunder Frank, Capitalism and Underdevelopment in Latin America: Historical Studies in Chile and Brazil (New York: Monthly Review Press, 1967; Andre Gunder Frank, Latin America:

This argument was repeated by Baran and Amin in their assessment of the role of transnationals on developing countries. Transnationals produced budget deficits for developing countries by extracting monies and resources. These scholars concluded that stagnation, indeed regression, would ensue in the third world since transnationals were replicating their oligopolistic and monopolistic structures in the Third World. The work of the American Marxist scholar Paul Baran best exemplifies the stagnationist perspective. Highlighting the impact of transnational expansion on the Third World, he reversed the "metropolitan" focus of the classical theories of imperialism. Baran's work influenced Andre Gunder Frank, the Latin American polemicist and political writer, the

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Underdevelopment or Revolution (New York:Monthly Review Press, 1969); N. Girvan, Corporate Imperialism: Conflict and Expropriation (New York: Monthly Review Press, 1976); H. Magdoff, The Age of Imperialism (New York: Monthly Review Press, 1969).

[41] N. Bukharin, Imperialism and World Economy (London: Merlin, 1972); J.A. Hobson, Imperialism - A Study (London: Allen & Unwin, 1938); V.I. Lenin, "Imperialism, the Highest Stage of Capitalism" in Selected Works Vol.1 (Moscow: Foreign Languages Publishing House, 1950); V.I. Lenin, The Development of Capitalism in Russia (Moscow: Progress Publishers, 1974); R. Luxemburg, The Accumulation of Capital (London: Routledge & Kegan, 1951).

most vehement proponent of the regressive dependencia perspective, whose contribution to the Third World developmental project was to change the perspective, the questions, and the discourse among mainstream American academic circles.

The dependency discourse served a useful purpose since it brought attention to the asymmetrical power relationship between industrialising countries and transnational corporations. Such discourses in their extreme conclusions perform important political and intellectual purposes.[42] Writers in the dependency persuasion asked scholars and political practitioners to take notice, to consider the potential possibility of no development for the newly independent countries if measures were not taken to undermine the existing power centres, among which transnationals featured greatly, that controlled global knowledge, wealth, and production. Regressive dependency brought attention to the constraints and difficulties that the newly independent countries would face if they remained passively locked in the capitalist world system, a state in which they were until the early 1960s. It was the era of transnational domination.

Dependency theorists were particularly concerned with the issue of the state's autonomy with respect to international capitalist structures, for they saw an autonomous state as the harbinger of autocentric development. Such a state, even a relatively autonomous one, was almost non-existent in the Third World during the 1950s and early 1960s. When dependency theorists spoke of the dependent third world state, they were referring to a state that had very little autonomy with respect to its global and international environment once it had chosen to be or had been inserted into the world capitalist system. Andre Gunder Frank lamented that while the state had an immense capacity for autonomous action with respect to civil society, it had almost no muscle with respect to its international and global counterparts.[43]

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[42] For a discussion of Andre Gunder Frank as a political, not an academic writer, see P.W. Preston, Rethinking Development: Essays on Development and Southeast Asia (London: Routledge & Kegan Paul, 1987) chap.6.

Based on the assumption that the interests of the advanced countries and developing countries did not coincide, a basic prescription of dependency scholars was that a strong state should undertake the task of setting developmental options and charting a course for the development of an entrepreneurial class. Dependency scholars perceived that despite all the rhetoric of anti-colonialism and anti-imperialism, the third world state seemed unable to regulate or control transnational capital.

Section III

Historical patterns had to change for a revolutionary situation of confrontation between transnationals and host government to emerge. There also had to be changes in government policy so that by the time the bargaining "balance of power" model,[44] the dynamic dependency[45] and Warren's orthodox marxist position[46] could receive credence the stage had been set for a relatively autonomous industrialising country state. As history unfolded and many examples of local capital accumulation and industrial growth became evident, a new crop of dependency scholars moved to introduce a "dynamic dependency" perspective to accomodate historical changes. In the behaviouralist tradition, American scholars began to measure and quantify, even if only to rebut Frank's claims, whether development was indeed occurring and whether transnationals were indeed exploitative. Frank's views, as those of Baran, were variously dubbed as reductionist, rhetorical, moralistic, ahistorical.[47] Palma observed that Dos Santos and Frank had fallen into a "stagnationist trap" when they inferred that dependency had reversed capitalism's historically progressive character,[48] a criticism that Bill Warren levelled against Lenin.

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[43] Andre Gunder Frank, Lumpenbourgeoisie - Lumpendevelopment (New York: Monthly Review Press, 1972), 4.

[44] See for instance, T.H. Moran, Multinationals and the Politics of Dependence: Copper in Chile (Princeton: Princeton University Press, 1974).

[45] Evans, Dependent Development, see chap. 1; Fernando Henrique Cardoso and Enzo Faletto, Dependency and Development in Latin America (Berkeley: Berkeley University Press, 1979), see xiv-xv, x-xi, 21.

[46] Bill Warren, "Imperialism and Capitalist Industrialisation," New Left Review 81 (September-October 1973), 3-44.

In 1977 Cardoso testily criticised North American and British academics for consuming Andre Gunder Frank's regressive dependency perspective, for dubbing dependencia a "theory" and for seeking therefore, to quantify and measure it. Cardoso and Faletto called regressive and stagnationist dependency perspectives "mechanistic".[49] The "dynamic dependency" scholars adopted a historical-structural approach emphasising that both external and internal factors produced dependency situations.[50] Over time, industrialisation and adjustments in dependency situations could be achieved through concerted efforts by the state, domestic entrepreneurs, and other social classes. Wallerstein,[51] Evans and Gerrefi have called this a special form of dependency, "dependent development" or semi-peripheral development in which "only a few (countries) are chosen".[52]

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[47] See for instance, Tony Smith, "The Underdevelopment of Development Literature: The Case of Dependency Theory," World Politics 31 (January 1979), 247-288.

[48] Gabriel Palma, "Dependency: A Formal Theory of Underdevelopment or a Methodology for the Analyses of Concrete Situations of Underdevelopment," World Development 6 (July-August 1978), 904.

[49] Fernando Henrique Cardoso, "The Consumption of Dependency Theory in the United States," Latin American Research Review 12 (1977), 7-24. It may be noted that Warren dismisses Cardoso's approach because its "dynamism is not matched by an emancipation from the same theoretical framework which uses the same term underdevelopment." Bill Warren, Imperialism: Pioneer of Capitalism (London: Verso, 1980), 162.

[50] Cardoso, "Consumption of Dependency," 10, 15.

The "dynamic dependency" perspective differed from the stagnationist, regressive perspective of development in its perception of the consequences of third world integration into the world capitalist economy. Whereas the regressive perspective expects underdevelopment or at the very least, stagnation, the dynamic dependency perspective expects industrialisation, where the pace and form of industrialisation coincides with the interests of transnational corporations and the demands of the advanced industrialised countries. All dependency scholars analyse how global capitalism conditions, shapes and constrains domestic structures and processes.[53] In addition, dynamic dependency scholars seek to comprehend how transformations in global capitalism produce possibilities for third world industrialisation.[54] As Evans argues in the case of Brazil, de-nationalisation is not a necessary result of transnational activity.[55]

Caparaso comments that in National Power and the Structure of Foreign Trade

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[51] Immanuel Wallerstein, The Modern World System: Capitalist Agriculture and the Origins of the European World-Economy in the Sixteenth Century (New York: Academic Press, 1974).

[52] Peter Evans, Dependent Development, 33.

[53] James A. Caporaso, "Introduction: Dependence and Dependency in the Global System," International Organization 32 (Winter 1978), 3. Caporaso applies this notion to all dependency perspectives. I apply it only to the dynamic dependencia perspective.

[54] Ibid.

[55] Evans, Dependent Development, 40-1.

Hirschman had foreseen the dependence/bargaining debate.[56] Writing about clashes between nation-states, he had observed that in their contests nation-states came furnished with specific resources but their power was also constrained by their structural position in the hierarchical and asymmetrical international system. Yet, in a rather Hobbesian manner he had argued that the weaker and more cunning party could improve its structural position through negotiation at the bargaining level and through conscious policy at the structural level.[57]

Section IV

In the 1970s and early 1980s, the bargaining balance of power model, also called the obsolescing bargain model, a phrase coined by Vernon,[58] gained currency as an analytical framework to study host government/foreign investors relations.[59] State autonomy was a prime concern of the model. The main objective of the bargaining "balance of power" model is to understand how host governments and domestic investors in industrialising countries seek to erode and often successfully reduce the bargaining power of the transnationals over time. It seeks to explain how transnationals preserve or lose their control over their firm-specific advantages and what factors enable them to hold host governments and local firms hostage. This is also a major consideration for the dependencia writers since they are concerned with the issue of state autonomy.

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[56] Ibid.

[57] Ibid., 6-7.

[58] Raymond Vernon, Sovereignty at Bay: The Multinational Spread of U.S. Enterprises (New York: Basic Books, 1971), chap.2.

[59] See among others Alfred Stepan, The State and Society: Peru in Comparative Perspective (Princeton: Princeton University Press, 1978), xii-xiii.

Firms use their internalised markets to gain power with respect to host governments and local firms and to prolong the longevity of their firm-specific advantages. Bargaining theory optimistically foresees the empowerment of weaker actors in an international system in which benefits are and will continue to be unequally distributed.[60] This view rejects the regressive and stagnationist dependencia perspectives according to which transnational/host government relations were zero-sum outcomes. Host governments and local firms, in the pursuit of their rational self interest, will seek to capture/erode these advantages. Grounded in an analysis of the epitome of capitalist structures - transnational corporations - the model is biased towards the existence and perpetuation of capitalist relations, for its validity rests on the operation of transnationals in industrialising countries.

The bargaining model originated in the non-neo-classical economics framework to analyse foreign direct investment - the theory of oligopolistic expansion developed by Hymer, Kindleberger, Vernon, Wells, and others.[61] Vernon, Moran, Penrose, Mikesell applied it to natural resource industries which were characterised by vertical integration, high geological, political and economic risks, and sunk costs.[62] The central thesis of the model is that because of the structure of transnational activity, the original contract between host governments is characterised by an extreme power disparity. But almost as soon as the ink has dried on the original agreement, host governments seek to change it. The bargaining balance of power model foresees a secular and progressive increase in the host government's autonomy with respect to transnationals which is viewed as a positive phenomenon.

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[60] Richard R. Fagen, "A Funny Thing Happened on the Way to the Market: Thoughts on Extending Dependency Ideas," International Organization 32 (Winter 1978), 287-300.

[61] Stephen Hymer, The International Operations of National Firms: A Study of Direct Foreign Investment (Cambridge, Mass.: The MIT Press, 1976); Charles P. Kindleberger, American Business Abroad: Six Lectures on Direct Investment (New Haven, Conn.: Yale University Press, 1969); Raymond Vernon, "International Investment and International Trade in the Product Cycle,"Quarterly Journal of Economics 80 (May 1966), 190-207. Also see Raymond Vernon, Sovereignty at Bay: The Multinational Spread of U.S. Enterprises (Penguin Books: Harmondsworth, 1973, Basic Books, 1971); Louis T. Wells, Jr., ed., The Product Life Cycle and International Trade (Boston: Harvard University, Division of Research, Graduate School of Business Administration, 1972).

The balance of power bargaining model draws heavily on industrial organisation theory or internalisation theory, the so-called "modern" theory of the growth of the modern firm. The theory explains the strategies that transnationals adopt to maximise their global profits and reduce their costs. General agreement exists in the literature regarding the origins of the concept of internalisation. In his 1960 doctoral thesis,[63] Stephen Hymer, the acclaimed progenitor of internalisation theory, was concerned with the transnational's strategies when it entered the host country.[64] In the mid-1970s,

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[62] Theodore H. Moran, Multinationals and the Politics of Dependence: Copper in Chile (Princeton: Princeton University Press, 1974), chap 6. Also see collection of articles in Raymond F. Mikesell, Foreign Investment in the Petroleum and Mineral Industries: Case Studies of Investor-Host Country Relations (Baltimore: The John Hopkins Press, 1971); Edith Penrose, The Growth of Firms, Middle East Oil and Other Essays (London: Frank Cass, 1971); Vernon, Sovereignty At Bay (Harmondsworth: Penguin, 1971), esp. chap.2.

[63] It was published in 1976.

[64] Stephen Hymer, The International Operations of National Firms: A Study of Direct Foreign Investment (Cambridge, Mass.: The MIT Press, 1976). Hymer drew upon a seminal paper written in 1937 by Coase who had defined the firm as a planning unit which supersedes the price mechanism. See R.H. Coase, "The Nature of the Firm," Economica (n.s.) 4, nos.13-16 (November 1937), 386-405.

Buckley, Casson, Richard Caves and John Dunning played a central role in elaborating the concept.[65]

The thrust of the concept of internalisation is that the actions of the firms can replace the market or alternatively can augment it. The explanatory power of the concept rests on an analysis of the costs and benefits to the firm of internalizing markets, particularly markets in intermediate goods.[66] The rationale of the firm is to avoid the transaction costs produced by imperfect markets.

Hymer argued that three factors influenced a firm's decision to invest overseas: it possessed an oligopolistic advantage;[67] it sought to pre-empt its rivals; and it internalised market imperfections. Hymer rejected the neo-classical assumption that foreign direct investment was the product of a higher marginal rate of return in perfect capital markets. Hymer argued that firms chose foreign direct investment because they possessed a quasi-monopolistic advantage from which they were unable to derive the full rents if they rented or leased the asset. This was because of the existence of a bilateral monopoly/oligopoly situation in which there were only a few buyers or sellers of the assets. Foreign direct investment also positioned them to enhance or safeguard their capacity to capture oligopolistic rents. Transnationals would invest in industries or stages of industries where the barriers to entry were the highest. These barriers would include the highest economies of scale, maximum research and development, and the greatest marketing effort.

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[65] Richard E. Caves, Multinational Enterprises and Economic Growth (Cambridge Surveys of Economic Literature, Cambridge: Mass, Cambridge University Press, 1983); John H. Dunning, International Production and the Multinational Enterprise (London: George Allen & Unwin, 1981); see Henry Ergas, "Explaining TNCs," Review of Multinational Enterprise and Economic Analysis by Richard E. Caves and International Production and Multinational Enterprises by John H. Dunning in The CTC Reporter (Autumn 1983), 53-56. Hymer's dissertation was published as The International Operations of National Firms: A Study of Direct Foreign Investment (Cambridge, Mass: The MIT Press, 1976).

[66] Peter J. Buckley and Mark Casson, The Future of the Multinational Enterprise (London: Macmillan Press, 1985), 9.

[67] The firm's oligopolistic advantage has often been called a monopolistic or ownership advantage in the literature.

Charles Kindleberger built upon Hymer's theoretical reasoning. He observed that the relationship between the transnational corporation and the government was based on a bilateral monopoly/non-zero sum outcome where the reserve prices of the two parties were far apart and that there was no determinate solution such as a competitive price.[68] Vernon added dynamism to the bilateral monopoly model with his "obsolescing bargaining" model. Moran notes that "it also offered a model of economic nationalism based on rational self-interest rather than on otherwise popular interpretations about machinations of leftists or waves of anti-foreign emotions."[69]

While neo-classical internalisation analysts argue that the existence of high transaction costs in external markets forces transnationals to enhance profitability and efficiency through internalisation, these non neo-classical economists reject the view that the activities of transnationals occur in impersonal, undistorted markets. Like governments, transnationals are viewed as creators, perpetuators, and beneficiaries of market imperfections. Transnationals are oligopolists, creating market imperfections through transfer pricing, the very act of producing a new product through research and development, and holding onto their innovations through internalisation.

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[68] Charles P. Kindleberger, Six Lectures on Direct Investment (New Haven, Conn: Yale University Press, 1969), 149-50.

[69] T.H. Moran, "Multinational Corporations and the Developing Countries: An Analytical Overview," in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. T.H. Moran (Lexington, Mass: D.C. Heath, 1985), 6.

Internalisation brings several advantages to the transnational firm: it can control and plan production; adopt discriminatory pricing mechanisms to enhance the global profitability of the firm; it can avoid bilateral market power, unpredictabilities in the transfer of knowledge, and government intervention through transfer pricing. Vertical integration enables the firm to reduce transaction costs, which is the most important objective of internalisation, according to neo-classical economists such as Rugman, Casson, and Buckley.

Firm-specific advantages include capital, technology and control of markets. The strategies that a firm will adopt to maintain control over its firm-specific advantages and to maximise its profits will include - vertical or horizontal integration, majority equity to withold technology, managerial and marketing expertise and the establishment of defensive oligopolistic structures with or without host government protection.

Since bargaining theory is concerned with state autonomy/domestic capital autonomy, it is silent about efficiency. If neo-classical internalisation theorists are correct about the efficiency-creating tendencies of the transnational firm through internalisation,[70] then it could be deduced that any attempt to erode internalisation -

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[70] Agmon and Hirsche argue that Third World countries gain greater benefits from transnational corporations that circumvent market imperfections because market imperfections are greater in the Third World than in the advanced capitalist countries. Tamir Agmon and Seev Hirsch, "Multinational Corporations and the Developing Economies: Potential Gains in a World of Imperfect Markets and Uncertainty," Oxford Bulletin of Economics and Statistics 41, no.4 (November 1979), 333-344.

which is what host governments and local firms in industrialising countries seek to do and which is the basis for bargaining analysis - would erode the efficiency of the firm and also according to some internalisation scholars, external efficiencies. Indeed, in his work on India, Encarnation concludes that greater state/local firm autonomy with transnationals was "won at the expense of economic growth."[71] But Encarnation does not examine the relationship between import-substitution industrialisation per se and slower economic growth.

The oligopolistic rivalry theorists, and I agree with them, are not convinced that transnationals create efficiencies in external markets. Charles-Albert Michalet notes that transnationals may reduce "market imperfections inside the transnationals and increase imperfections in the external market."[72] Defensive oligopolies create inefficiencies in the host economy and increase the price to consumers. If the firm-specific advantages accruing to transnationals are not available on the open market, they can charge oligopolistic rents, especially if they agree to preserve this dominance through cooperation with their major rivals internationally. "Transnational entry may, in the highly fragmented, inefficient or missing markets for factors, knowledge, skills, and institutions in developing country, boost the efficient development of some markets while retarding others."[73] Transnationals do seek to control specific niches in the markets that are concentrated and where the barriers to entry are the highest. In fact, they deliberately ask for government protection in search of limited competition.[74]

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[71] Encarnation, Dislodging Multinationals, 12.

[72] Charles-Albert Michalet, "The Internalisation Concept Revisited," The CTC Reporter (Autumn 1989), 63.

[73] Sanjaya Lall, "Multinational Enterprises and Developing Countries," Millennium Journal of International Studies 20 (Summer 1991), 252.

Moran notes that the oligopolistic theory of the firm, like the dependency perspective, emphasises that a prime concern of host country policy makers would be the "proper price" to be paid to foreign investors.[75] Or to put it another way, how much of their oligopolistic rents were transnationals entitled to keep? Edith Penrose normatively established a base price: the foreign investor should receive only the amount that was necessary to tempt it(or others) to invest and to prevent it from withdrawing. If the foreign investors extracted a greater share of rent, the host country policy makers could interpret that as exploitation.[76]

Charles Kindleberger contested Penrose's formulation based on the argument that the upper limit would be determined by the scarcity value of the transnational's services. Although Penrose later agreed with Kindleberger,[77] in my view, her formulation was adequate since the base price is never a static price but a variable price which alters depending on the scarcity value of the transnational's services - the price at which the country would rather do without the foreigner's services.

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[74] See Rhys Jenkins, Uneven Development, chap. 3 for a discussion of the neo-classical and dynamic dependency perspectives on the role of transnationals in compeition and concentration. Also see Richard S. Newfarmer, Transnational Conglomerates and the Economics of Dependent Development: A Case Study of the International Electrical Oligopoly and Brazil's Electrical Industry (Greenwich, Conn: Jai Press, 1980), 15-21.

[75] T.H. Moran, "Multinational Corporations and Dependency: A Dialogue for Dependentistas and Non-Dependentistas," International Organization 32 (Winter 1978), 81-2.

[76] Edith Penrose, The Growth of Firms, Middle East Oil and Other Essays (London: Frank Cass & Co., 1971), 152-164.

[77] Edith T. Penrose, "International Economic Relations and the Large International Firm," in New Orientations: Essays in International Relations ed. E.F. Penrose, Peter Lyon, Edith T. Penrose (London: Frank Cass and Co., 1970), 107-136.

Moran has added to the obsolescing bargain model by bringing it into the political economy analytical framework.[78] He broadened it to include internal and domestic factors, the role of economic nationalism. He fleshed out the hypothesis of the model to accommodate the constraints on state action that dependency scholars emphasised. He argued that short-run oscillating swings in the bargaining power of transnationals and host governments could be expected at specific historical junctures, despite the overall secular trend in favour of the host government.[79] This is why the criticism levelled against the bargaining balance of power model by the new crop of dependency scholars is a trifle far-fetched. They tend to view the bargaining "balance of power" bargaining model as static, a model that does not give adequate attention to the gap between the translation of power resources into actual capabilities, the unwillingness of host governments to exercise their bargaining power with respect to transnationals, their inability to do so because of international and domestic constraints or out of pure ignorance or perceived weaknesses.

Moran outlines three classes of premises to predict the distribution of benefits at the micro-level when transnationals, host governments, and/or local entrepreneurs negotiate a specific investment agreement.[80] These premises can be used to forecast how these benefits will be distributed over time or at the macro-level to describe the changes in the benefits that transnationals and host governments might extract over time. Over time, host governments would pay less for the services of the transnationals as their negotiating and industrial capacity increased and if there was greater competition among transnationals. But Moran notes that transnationals could still be expected to remain more powerful with respect to poor host governments or in industries where technology rapidly obsolesced.

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[78] T.H. Moran, Politics of Dependence, Chap.6; T. H. Moran, "Multinational Corporations and the Developing Countries: An Analytical Overview," in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. T. H. Moran, (Lexington, Mass.: Lexington Books, D.C. Heath, 1985), 1-24.

[79] Moran, Politics of Dependence, 167-9.

[80] Moran, "Dependentistas and Non-Dependentistas," 81-5.

The first group of premises - which serve as independent variables - comprise the characteristics of the project. These characteristics include: the absolute size of the investment, the ratio of fixed to variable costs, stability of technology, and marketing complexities.[81] Variations in these project-specific characteristics generally influence the relative bargaining power of the state with respect to transnationals and they enable the analyst to predict the outcome of the bargain. At entry, the bargaining power of transnationals will be greater if their planned projects involve low fixed investments and costs, changeable technology, and complex marketing. Firms with contrasting characteristics will be more vulnerable to host country demands for which they will demand a higher "base price". But once these firms have sunk investments they would be unable to make a credible threat to withdraw when the host government seeks to renegotiate their original agreement and demands access to new technology or marketing strategies.

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[81] C. Fred Bergsten, Thomas O. Horst, Theodore H. Moran, American Multinationals and American Interests (Washington, D.C.: Brookings Institution, 1978).

The second set of hypotheses focuses on host country characteristics.[82] All other things being equal, the host state's bargaining power would be greater when there is: a large and growing domestic market; a highly mobilised local population demanding jobs and social programs which would force the government to put pressure on foreign investors; an experienced bureaucracy - conversant with industry practices such as transfer pricing and oligopolistic distribution and pricing mechanisms - and unwilling to allow transnationals to indulge in them; and a strong domestic entrepreneurial class able to replicate some of the functions of transnationals which would "increase the credibility of nationalisation or a transfer of ownership to domestic investors (if nationalist demands are not met) and lower the opportunity cost of failure if nationalist demands are pushed too far."[83]

Exogenous factors comprise the third set of hypotheses. The government's bargaining power would be stronger where the industry is characterised by low uncertainty and high international competitiveness. Its antithesis would weaken the host government, either at the time of entry or over time.[84]

Host countries derive their bargaining power from various sources: the degree of competition in the industry, the size and growth rate of the domestic market, the level of local technology and managerial capacity[85], skilled labour for high technology industries. The host government must use these assets to its advantage. It controls access to markets and resources. It can stipulate terms of entry such as restrictions on which industries are open to investment, tax treatment, degree of local sourcing etc. and terms of continued operations such as repatriation rates, inclusion of national partners, etc.

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[82] Louis T. Wells, Jr. "The Evolution of Concession Agreements in Developing Countries," Harvard Development Advisory Service, (March 29 1971) cited in Moran, "Dependentistas and Non-Dependentistas," 83, n.10.

[83] Ibid., 83.

[84] Edith T. Penrose, The Large International Firm in Developing Countries: The International Petroleum Industry (London: Allen and Unwin, 1968); Raymond Vernon, Sovereignty at Bay, Chapter 3; and Raymond F. Mikesell, "Conflict in Foreign Investor-Host Country Relations: A Preliminary Analysis," ed. Raymond F. Mikesell Foreign Investment in the Petroleum and Mineral Industries (Baltimore and London: The John Hopkins Press, 1971).

The ability of the government to take advantage of these opportunities depends upon the goals and negotiating and technical skills of officials.[86] Government officials can bargain most effectively when they have specific information about the real rate of return to an enterprise and the technical aspects of the operation.[87] Host governments may coordinate policies and unify their approaches to the companies, strengthening their bargaining positions. No more timely example is available than the OPEC countries' confrontation with the oil transnationals in the early 1970s.

Section V

"Although levels of industrial development have risen for nations in this situation, many of the previously existing dependency links have been maintained or redefined... thus reinforcing certain patterns of underdevelopment associated with the more classic forms of dependency."[88] Therefore while states may bargain, they also remain in a state of dependency. This is the crux of the dynamic dependency perspective. The "dynamic dependency" scholars who have adopted the bargaining balance of power model have been critical of the model's explanatory value in their discussion of the triple alliance among foreign capital, domestic capital and the state. They argue that host governments may have the capacity to exercise greater negotiating strength with foreign investors but they may not have the political will to do so. Also some strengths may be cancelled out by other weaknesses and by other policy priorities of the state. Thus, the state may have to forego increasing its own involvement in an industry and moving from a position of rentier to competition with respect to foreign investors because of balance of payments constraints.

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[85] Paul Streeten, "The Theory of Development Policy," in Economic Analysis and the Multinational Enterprise ed. J. Dunning (London: Allen & Unwin, 1974).

[86] Newfarmer, Transnational Conglomerates, 12.

[87] Constantine Vaitsos, Inter-Country Income Distribution and Transnational Enterprises (Oxford: Clarendon Press, 1974), 135-147.

[88] Gary Gereffi, The Pharmaceutical Industry and Dependency in the Third World (Princeton: Princeton University Press, 1983), 21.

The existing paradigms, relevant for their specific historical context, required re-examination. A new group of scholars emerged to amalgamate the bargaining and dependency perspectives. Although Gary Gerrefi, Bennette and Sharpe, Richard Newfarmer, and Mytelka used the balance of power bargaining model, they did not find significant increases in the host government's power over time.[89] In fact, they argued that transnationals could become more powerful over time for a host of reasons. Technological entry barriers, alliances between foreign and domestic capital, and globalisation prevented the erosion of the transnational's firm-specific advantages by local and foreign enterprises.

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[89] Douglas C. Bennette and Kenneth E. Sharpe, Transnational Corporations Versus the State: The Political Economy of the Mexican Auto Industry (Princeton: Princeton University Press, 1985); Newfarmer, Transnational Conglomerates; Gary Gereffi, Pharmaceutical, 48; Lynn K. Mytelka, "Technological Dependence in the Andean Group," International Organization 32 (Winter 1978), 101-140.

With a few exceptions, because of host country differences, the application of the obsolescing bargain model to manufacturing industries has not shown significant increases in the host government's bargaining power in industries where technological innovations are swift and carefully guarded. The results are mixed and the number of case studies are small. In general, manufacturing industries do not involve the high risk, the national prominence and sensitivity, and the massive sunken investments required by natural resource industries.[90]

Several studies have revealed that host governments cannot hold manufacturing foreign investors hostage as easily as they can in the natural resource sector. Firms tend to prevent the erosion of their firm-specific advantages by creating new ones when the old ones are undermined. Manufacturing firms have more options: they can innovate, become export-oriented and withdraw if they find the host government's demands too onerous. The results of these country/industry-specific studies reinforce the expectations of scholars such as Bergsten, Moran, and Horst. By contrast, where technological diffusion is rapid and products are standardised there is a concomitant shift in favour of host governments/local entrepreneurs.

This conclusion leads to another inference. In the manufacturing sector shifts in the bargaining power of host governments follow the logic of the world capitalist system: they are consistently prevented from entering the highest rungs of technological innovation because of their position in the world capitalist system.

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[90] Stephen Kobrin, "Testing the Bargaining Hypothesis in the Manufacturing Sector in Developing Countries," International Organization 41 (Autumn 1987), 613.

Here Raymond Vernon's product cycle model of trade and investment is useful. It assumed that the international economic system is hierarchial and shifting. A logical conclusion of this theory from the perspective of the host country is: when a technological development is ready to be discarded in the industrialised world, when it has fulfilled its purpose and is no longer profitable, it can be transferred to industrialising countries.[91] This view, that the international division of labour was shifting while the hierarchy and the asymmetry between the centre and the periphery remained, was shared by later scholars in the dependency persuasion, including Evans.[92] As Evans argues, "saying that a country is 'dependent' does not indicate that its relation to the international economic system is immutably fixed."[93]

While Vernon's model became limited in a changing historical context, a fact that he tried to rectify in his later works, the general comparative advantage component remained valid. In this view, third world industrialisation is possible but according to the logic of the expansion of the transnational on a world-scale. Technology has to become standardised before it can be shared with industrialising country governments or firms.

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[91] The essence of the model was that new products were initially produced in a high-income country, notably the United States during the 1950s and 1960s, but will eventually spread throughout the world, first to other advanced countries, but later to developing countries, in a trickle-down fashion as the products mature and become technologically standardised. Raymond Vernon, "International Investment and International Trade in the Product Cycle," Quarterly Journal of Economics 80 (May 1966), 90-107?; Harry Johnson, Comparative Cost and Commercial Policy Theory for a Developing World Economy (Stockholm: Almquist and Wiksell, 1968); Louis T. Wells, The Product Life Cycle and International Trade (Cambridge, Mass: Harvard University Press, 1972).

[92] Evans, Dependent Development, 27.

[93] Ibid.

The technology that developing country firms can most easily access is the technology over which transnationals are most willing to relinquish control.

While host governments climb the learning curve, so do transnationals.[94] Indeed, internalisation theorists alert the managers of transnationals to remain constantly aware of the changing environment in their host country so as to prevent the erosion of their firm-specific advantages. Firms seek to reduce the leverage of host countries/local investors by internalising their location-specific advantages. Joint ventures are a case in point. While host governments establish certain rules and regulations which provide the basis for negotiation as they climb the learning curve, firms seek to pre-empt host country regulations by taking measures that will enable them to retain the maximum control over their firm-specific advantages.

At the moment of entry, local firms may possess special skills, special contacts, or special methods of taking advantage of local market imperfections that foreign investors need to become successfully established. Transnationals overcome these firm-specific disadvantages, especially in low technology, standardised industries through joint ventures.[95] In this way, transnationals can internalise the superior advantages that domestic firms enjoy. Further, by reducing domestic firms to their junior partners, transnationals can, at least in the short-term, neutralise their most powerful potential domestic rivals. This is why the joint venture form, especially one in which local firms have a minority share, is a particularly useful risk-sharing instrument for transnational corporations. Therefore, the establishment of joint ventures cannot be uncritically accepted as a reflection of increased state regulation or increased bargaining power of the state or local capital.

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[94] T.H. Moran, "International Political Risk Assessment, Corporate Planning, and Strategies to Offset Political Risk," in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. T.H. Moran (Lexington, Mass.: Lexington Books, D.C. Heath, 1985), 107-118.

[95] See Lawrence G. Franco, Joint Venture Survival in Multinational Corporations (New York: Praeger, 1971); Louis T. Wells, Jr., "The Multinational Business Enterprise: What Kind of International Organisation?" in Transnational Relations and World Politics, ed. Robert Koehane and Joseph S. Nye Jr, Special issue of International Organization 25, no.3 (Summer 1971), 447-464.

Section VI

In explaining the relation between past and present scholars have exaggerated the break with the past. This has been a recurring theme in recent political science and particularly international politics literature.[96] This break was first hailed during the confrontation between transnationals and sovereign states in the 1970s. Now it is being fuelled by the current debate about the longevity of sovereign states because of the emergence of the new techno-global firm. Global integration and the technological revolution of the 1980s and 1990s has forced host governments to make concessions to transnational corporations. Consequently, the relative increase in the bargaining power of the transnationals has been the subject of much discussion in the last decade and a half. The bargaining "balance of power" model has retained its validity despite the mixed results in the industry-specific studies that have been written and despite the new era of "peaceful negotiations" between transnationals and host governments in this era of transnational ascendancy.[97]

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[96] Gourevitch has made this point with regard to the link between international politics and domestic politics. Peter Gourevitch, "The Second Image Reversed: The International Sources of Domestic Politics," International Organization 32 (Autumn 1978), 882.

The investment climate in industrialising countries is benign in the 1990s compared to the 1970s. In the present peaceful era of negotiation which is also the era of transnational ascendancy, host governments have access to some irreversible power resources that they accumulated during the 1970s and 1980s. Consequently, this era is different from the era of transnational domination. The disparities between transnationals and host governments are less extreme and asymmetrical, even when governments have to grant allowances to the transnationals. Transnationals have become habituated to greater state intervention in their affairs and to the obsolescence of their original bargain which allows for greater flexibility in the relations between the two parties.

In the oil industry, developing country governments "believe that a new generation of agreements can ensure that investment in mining and oil is consistent with the long-term management of non-renewable resources."[98] The oil transnationals have since the 1970s been forced to relinquish many of the advantages that they had internalised through vertical integration because of host state incursions. A regulatory framework has become an accepted part of the bargaining paraphernalia.

In its 1983 Third Survey the United Nations observed that host governments had accumulated managerial and technological capabilities in their private and public enterprises; transnationals had become flexible in their willingness to accept a variety of contractual arrangements; many governments had become self-assured in their ability to negotiate reciprocally expedient business contracts "through more calibrated systems of control and monitoring"[99] and to alter the costs and benefits attached to foreign investment through regulation rather than nationalisation.[100] According to Tavis, this is partly because transnationals have begun to explicitly recognise their role as good corporate citizens.[101] Host governments now negotiate with transnationals from a position of knowledge rather than ignorance. Consequently, they now utilise economic nationalism sparingly. Governments rarely accuse transnationals of domination and exploitation in the 1990s.

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[97] Michael Minor, "Changes in Developing Country Regimes for Foreign Direct Investment: The Raw Materials Sector, 1968-1985," in Essays in International Business (Centre for International Business Studies: The University of South Carolina, 1990), 1-45.

[98] Roland Brown, "Contract Stability in International Petroleum Operations," The CTC Reporter no.29 (Spring 1990), 56. For a discussion of the replacement of confrontation by pragmatism in negotiations between transnationals and host governments in the oil industry see for instance United Nations, Centre on Transnational Corporations, Transnationals in World Development (New York, 1988), 318.

Although the relations between host governments and transnationals are calmer and governments have allowed liberal winds to blow over their territories, they are still suspicious of the benefits of foreign investment and its incursions on state power.[102] "Few developing countries have dismantled the entire legal framework for exercising control over the transnationals or for evaluating the benefits and burdens of particular foreign investment proposals."[103] Indeed, scholars such as Charles Kennedy and Robert

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[99] United Nations, Centre on Transnational Corporations, Transnational Corporations in World Development Third Survey (New York: United Nations, 1983).

[100] Ibid.

[101] Lee A. Tavis, "The Role of Multinational Corporations in the Third World," in Multinational Managers and Host Country Interactions ed. Lee A. Tavis (Notre Dame, Indiana: University of Notre Dame Press, 1988), 1-2.

[102] United Nations, Centre on Transnational Corporations, Transnationals Corporations in World Development:Trends and Prospects (New York: United Nations, 1988), 314.

[103] Ibid., 319.

Grosse,[104] who see the current weakness of Latin American governments with respect to transnationals as merely the product of the debt crisis, expect the explosiveness of the 1970s to recur. However, several structural changes have occurred which will deter such explosiveness.

Four global structural changes have occurred in the present era which have forced host governments to make concessions to transnationals and to liberalise their investment climates. First, post-fordist, just-in-time, home grown production strategies in the advanced industrialised countries have reduced the demand for third world fordist-type mass-produced goods. Second, techno-globalism is an irreversible phenomenon. Susan Strange observes, "...it is structural change that has driven developing countries into the arms of transnationals and it is the same structural change that has driven transnationals into the arms of developing countries' governments."[105]

Encarnation's study on India shows that despite the government's capacity in enhancing its bargaining power with respect to transnationals it has been unable to dislodge them because they show the technology card whenever the Indian government's demands appear too onerous.[106] "In industry, after industry, multinationals acted first to reverse the obsolescence of their earlier bargains and then to minimise the possibilities of future obsolescence."[107] Third, the debt crisis has weakened host governments. The international financial and monetary institutions and host governments are wooing transnationals to ease indebtedness.[108] The first two appear to be permanent fixtures in the new global economy; the third is a temporary phenomenon.[109]

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[104] Robert Grosse, Multinationals in Latin America (London: Routledge, 1989), 250-255; Charles Kennedy, "Relations Between Transnational Corporations and Governments of Host Countries: A look to the Future," Transnational Corporations 1 (February 1992), 67-92.

[105] Susan Strange, "Big Business and the State," Millennium Journal of International Studies 20 (Summer 1991), 248.

[106] Encarnation, Dislodging Multinationals, 8.

A fourth structural change, the product of combined host-country and corporate strategies, has emerged as new forms of investment are replacing old ones, i.e transnationals are letting/leasing their ownership-specific advantages - technology and marketing experience - in unbundled forms, forms in which state and local enterprises in host countries seemingly prefer to receive them. As a result, the practical relevance of internalisation is being questioned so that in his "eclectic" approach John Dunning was moved to separate a firm's ownership-specific advantages from its firm-specific assets.[110]

This is precisely why it is important for the state to be interventionist. While this structural change is touted as an advantage to domestic private and public firms in host countries, it is also the product of the transnationals' desire to avoid the market imperfections that it would encounter by establishing production facilities in host countries. Indeed, Hymer's other hypothesis, that firms would let/lease their products if they could extract the full oligopolistic rent for their asset in a competitive market place with many buyers, is underway in a number of industries, such as the service sector and the production of shoes and apparel. The rapid obsolescence of technology has made it uneconomic to prolong the longevity of assets through direct foreign investment as massive amounts of money must be spent to keep up with new research and development at home.

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[107] Ibid., 24.

[108] Tavis, "Multinational Managers," 2.

[109] Susan Strange, "Big Business," 248.

[110] John H. Dunning, Explaining International Production (London: Unwin and Hyman, 1988); John H. Dunning, Multinationals, Technology, and Competitiveness (London: Unwin and Hyman, 1988).

Although capital and marketing are still potent firm-specific advantages, technology is the most important advantage that transnationals enjoy in the 1990s. But governments cannot be swept away in the technological torrent. The new global environment requires an activist state, not a minimalist state. Moran notes, as competition among host governments increases for the services of transnationals, the minimalist state will lose out. In his book The Competitive Advantage of Nations, Porter argues that it is governments that are ultimately responsible for designing the rules that will determine whether countries achieve competitiveness.[111]

Sanjaya Lall argues that governments will have to intervene to determine how well "technology is absorbed, diffused, and built upon by the host country."[112] He warns that "the impact of a strong MNE presence, with established links with science and technology institutions in advanced home countries, may not contribute to infra-structural development in less advanced countries."[113] Sampson expects continued tensions between the more technologically advanced developing countries and transnationals.[114] This is exemplified in Brazil's recent confrontations with the computer transnationals and the U.S. government in recent years.[115] Further, the state and local capital are not suddenly going to lose their ability to continue to improve their technological, financial, and marketing prowess. That process will continue. As Evans has shown in the case of Brazil's computers, the state and local capital continue to ascend the learning curve, even though they might still be in a dependency relationship. One does not preclude the other.[116]

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[111] John H. Dunning, "The Competitive Advantage of Countries and the Activities of Transnational Corporations," review of The Competitive Advantage of Nations by M.E. Porter in Transnational Corporations 1 (February 1992), 141.

[112] Sanjaya Lall, "Multinational Enterprises," 252.

[113] Ibid., 254.

Citing the case of Brazil, which is two years behind in state-of-the-art computer technology, Strange argues that the activist state will have to exercise care in negotiating with transnationals if it wishes to remain competitive.[117] It is precisely because of this that technological issues will be on the bargaining agenda since host governments will only be prepared to make concessions to transnationals if they can access state-of-the art technology. Governments and strong local entrepreneurs in developing countries will not be satisfied with obsolete technology. States will be selective in giving out incentives to transnationals.

Further, it is not necessary for all local firms or all host states to achieve the highest quality at the cost of transnational dominance. Not all consumers utilise top quality products. Many industrialising country firms can target consumer demand in local and export markets in the medium and low-end of the product cycle as long as they can provide competitive prices and guarantee quality within that range. However, to compete on the global market they cannot afford to lose out on efficiency. For this they will have to make concessions to transnationals. Here, too, their place in the industry's hierarchy will be determined by access to technology.

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[114] Anthony Sampson, "Work Elsewhere: TNCs in the 1990s," The CTC Reporter (Spring 1988), 39-41; 52.

[115] Peter Evans, "State, Capital, And the Transformation of Dependency: The Brazilian Computer Case," World Development 14 (1986), 791-808; also see Peter Evans, "Declining Hegemony and Assertive Industrialization: U.S.-Brazil Conflicts in the Computer Industry," International Organization 43 (Spring 1989), 207-238.

[116] Evans, "The Brazilian Computer Case," 803-805.

[117] Strange, "Big Business," 245-250.

When a host government is confronted with the task of restructuring its industrial sector towards more technologically complex industries and improving its productive efficiency to increase the supply of exportable products, the balance of power will shift in favour of the transnational corporation. The transnational is once again able to capitalise on its firm-specific advantages - capital, modern technology, quality-control systems, and its global distribution and marketing channels.

Reductions in the state's bargaining power with respect to transnationals due to indebtedness or falling commodity prices must be separated from reduced bargaining power because of the structural changes that characterise the global economy. Generally, the obsolescing bargain model expects that in industries with rapidly changing technology it is unlikely that there will be sharp increases in the state's bargaining power compared to a natural resource industry or a manufacturing industry with standardised technology.

In a natural resource industry such as petroleum, the bargaining "balance of power" model permits the introduction of some flexibility. In the 1990s, the swings in the "balance of power" between transnationals and host governments are moderate and less confrontational. If a transnational's discounted cash flow rate is 15 percent, the host government cannot expect a drastic reduction in its profitability. The room for manoeuvre has narrowed since the time when oil transnationals gave host governments a notional 50 percent profit. Host governments are also not willing to relinquish a much larger share of revenues to the transnational. They may now allow a 25-30 discounted cash flow for more costly projects as opposed to the traditional 10-15 percent.

In this chapter I have outlined the major features and interests of the three major sets of actors - state, transnationals, and public and private capital - that inform the substance of this study. Transnationals continue to exercise considerable market power which acts as a constraint on the host state's ability for autonomous action. The state is always constrained, more or less, by foreign and domestic actors and structural conditions, so that complete autonomy is never a realistic possibility.

The capitalist state is constrained by the logic of capitalist accumulation and by the interests of its most powerful allies, the transnationals, who organise capitalist production. The relative ability of domestic capital to constrain the state depends on the extent to which it is participant in capital formation and a contributor to government revenues. Its position as a coalition partner can change from weak to strong, for which to remain legitimate, the capitalist state will have to re-adjust the distribution of benefits among its allies. Over time, re-adjustments of the alliance structure are likely as the capitalist state seeks to pursue its two, often contradictory interests, legitimation and accumulation. The state itself has entered the capital accumulation process as a promoter of private capital accumulation as well as its competitor, through its state enterprises. As the state develops interests of its own, conflicts arise among the various members of the triple alliance. In addition, the state has to juggle its own contradictory interests.

In sections II, III, and IV I have traced the historical development of the three major frameworks for analysing host government/foreign investor relations that emerged after World War II. The essence of this discussion is that each set of perspectives grew out of and in response to changing realities in the global economy and the transforming relations among transnationals, the state, and local capital. Therefore, the criticisms of each perspective must be limited to the historical period that they sought to explain and from which they drew their visions of the future instead of extrapolating those criticisms to other historical junctures which are redundant. In the final section, I have outlined the recent emergence of an old debate, whether or not the state will be over-run by transnationals in this new age of techno-globalism and privatisation. I conclude that the state is here to stay until it mutates into something else. Until then, it will continue to be in a dependency situation but the state and local capital will also continue to erode the transnationals' firm-specific assets with varying degrees of success. And until then, its vested interest in economic management is too entrenched to allow transnationals to rule the roost.

Chapter 2

The Colonial Legacy

This chapter has three themes. First, the chapter shows how merchant capital destroyed the entrepreneurial spirit among the natives. This theme serves as a prelude to analysing the bargaining relations among the state, domestic capital and foreign capital in the textile industry after 1949. Second, this chapter demonstrates how the colonial state, by centralising control over land, ensured that the native ruler became a rentier par excellence and peasants no longer had subsoil and surface rights. This permitted laissez-faire liberalism to flourish with transnational activity in the later colonial years. Third, this chapter demonstrates how the colonial state began to bargain with the oil companies and laid the foundations for bargaining between the post-colonial state and the oil transnationals. The last two themes provide the historical background to understand bargaining between the post-colonial Indonesian state and foreign capital in the oil industry.

Part - I

The structural conditions for the absence of an entrepreneurial class in Indonesia which made it necessary to invite foreign capital in 1967, are rooted in the era of merchant capital, not the colonial era.[1] The most significant factors that led to the destruction of the entrepreneurial spirit and the creation of the rentier spirit among indigenous Indonesians were the strategies that the VOC adopted to control output: the product of the pre-eminence of merchant capital in the Dutch Republic. The Culture-System that involved state-led cash crop production during the colonial era was also the product of merchant capital's predominance during the previous two centuries. The Netherlands missed the first industrial revolution because of the predominance of merchant capital.

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[1] Few scholars consider the Dutch East India Company's commercial hegemony over the East Indies as a distinct phenomenon in Indonesian history, to be separated from the

This discussion provides the background for Chapter 5 where I will discuss the bargaining relations among the state, foreign capital, and domestic capital in the post-1969 textile industry. There I will show that in 1949, when Indonesia gained independence, Chinese merchants dominated retail and petty trading. The indigenous

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configurations characterizing indigenous state systems prior to and in some cases co-existing with the merchant company. Most historians use the beginning of the nineteenth century to distinguish between the pre-colonial and colonial East Indies. Such a demarcation is accurate from a technical perspective since the Dutch state acquired the VOC's territories in January of 1800. However, it is biased because it assumes that the VOC's activities in the East Indies left the indigenous socio-economic structure untouched. While the old social formations persisted in areas of little interest to the merchant company, the VOC created a new socio-economic order in those parts of the East Indies which it brought under varying degrees of control ranging from territorial dominion and the extraction of tribute to the extermination of whole populations in certain islands. See for instance, R.E.Elson, "Aspects of Peasant Life in Early 19th Century Java," in Nineteenth and Twentieth Century Indonesia: Essays in Honour of Professor J.D. Legge, ed. David P. Chandler and M.C. Ricklefs, (Clayton, Vic: Southeast Asian Studies, Monash University, 1986), 57-82; Robert Van Niel, "The Effect of Export Cultivations in Nineteenth Century Java," Modern Asian Studies 15 (1981), 48-49. Joel Kahn is perhaps the only scholar of Indonesian history who recognizes the impact of merchant's capital on the East Indies economy in his study of Minangkabau social formations in West Sumatara. Joel S. Kahn, Minangkabau Social Formations: Indonesian Peasants and the World-Economy (Cambridge University Press: Cambridge, 1980). However, no other scholar has considered it necessary to debate his contentions or incorporate his analysis into their studies of Indonesia's pre-colonial experience.

Indonesian was a rentier. These factors made it impossible to achieve import-substitution industrialisation in the first two decades of independence. It therefore became the task of foreign industrial capital in the late 1960s to destroy the primacy of indigenous Chinese merchant capital in Indonesia to begin the import-substitution industrialisation drive in earnest.

Section I

Marx distinguishes between merchant and industrial capital.[2] Merchant capital or trading capital embodies two categories - commercial and financial capital.[3] The major difference between merchant capital in the capitalist mode of production and merchant capital in all previous modes of production is that in the former merchant capital performs a specific function and is subordinate to industrial or productive capital. In the latter, merchant capital alone performs the function of capital.[4]

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[2] The discussion in this section is based on Marx's analysis of merchant capital in Karl Marx, Capital: A Critique of Political Economy III, (Chicago: Charles H. Kerr, 1909), Pt.IV.

[3] Ibid., 314-315. Marx makes a clear distinction between merchants' capital which is involved in the specific form of circulation - M C M' as distinct from industrial capital whose involvement in the circulation of capital is exemplified in the C' M C" circuit. Ibid., 318-323. Heilbroner inaccurately speaks of the dominance of the M C M' circuit in the capitalist mode of production. He erroneously concludes that it is the extent to which money plays a "capital like function" rather than the role it plays which determines whether a social formation is capitalist. R.L. Heilbroner, The Nature and Logic of Capitalism (New York: W.W. Norton, 1985), 35-38. Based on this notion it would be possible to argue that the capitalist mode of production dates back at least to the beginning of the seventeenth century when there was a tremendous increase in the circulation of money on a world scale. All capital - commercial, finance, and industrial - correctly fall under the rubric of the capitalist mode of production when industrial capital is predominant and commercial and finance capital play subordinate roles. This was not the case in the Dutch Republic which enjoyed commercial and financial hegemony in the seventeenth and eighteenth centuries.

[4] Marx, Capital, 329-330.

Marx argues that "the development of merchant capital is inversely proportional to the degree of the development of the capitalist mode of production."[5] It follows that the more highly developed is merchant capital, the greater the likelihood that the growth of industrial capital will be stunted or thwarted. This inverse relationship between merchant and industrial capital becomes evident when merchant capital, which characteristically adjusts itself politically and socially to other modes of production,[6] controls production directly to enhance profits while preserving the old mode of production. As long as the manufacturers' activities are subordinate to the requirements of merchant capitalists who also derive the major share of profits, industrial capital cannot develop.[7]

Section II

Merchant capital and finance capital dominated the Dutch Republic in the 17th and 18th centuries. English language accounts of the rise of Dutch commercial supremacy do not provide a well documented account of the structures of production in the seventeenth century. However, the singular event that the Dutch manufacturing sectors declined immediately following the Dutch Republic's commercial decline, suggests that merchant capital was not revolutionary in character. Following Marx, it is possible to argue that because merchant capital was so highly developed, the manufacturing sector remained subordinate to it, declining with the former's demise. Merchant capital did not make the transition to industrial capital. Rather, commercial capital became financial capital.

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[5] Ibid., 387.

[6] "From the eleventh to the eighteenth centuries merchant capital had always been able to adapt itself both politically and socially to the feudal ruling classes who were the main consumers of their luxury products and the "main recipients of private and government loans." Rodney Hilton, "Capitalism, What's in a Name?" in The Transition, 152 cited in Colin Mooers, The Making of Bourgeois Europe: Absolutism, Revolution, and the Rise of Capitalism in England, France and Germany (London: Verso, 1991), 15.

[7] Marx, Capital, 394.

Although Wallerstein has provided the lone theoretical construct describing the Dutch Republic's position in the world economy of the seventeenth century[8] his evidence is flimsy and his conclusions are faulty. He overstates and misinterprets the original meaning of his source materials when referring to the seventeenth century Dutch Republic when he declares, "we are in the presence of industrial capitalism."[9] Wallerstein must contend with Marx's oft repeated question: Why did industrial capitalism not develop in the Flemish and Italian centres of the thirteenth and fourteenth centuries where there was a great concentration of merchant capital combined with considerable numbers of wage labourers?[10]

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[8] Immanuel Wallerstein, The Modern World-System II: Mercantilism and the Consolidation of the European World-Economy: 1600-1750 (New York:Academic Press,1980), 42 n.32.

[9] Wallerstein, Modern World System, 45. Besides his general discussion on commercial supremacy, there are four sentences in his entire chapter on the Dutch Republic on which he make his cases for capitalist industrialization. Wallerstein misconstrues the meaning of at least two of his sources. He quotes Supple, "it was a perfectly normal and anticipated practice for commercial entrepreneurs to invest in and manage manufacturing enterprises". See Wallerstein, Modern World System, 56, n. 120. Supple is making a general statement about European manufacturing enterprises not a specific statement about the Dutch Republic. See Barry E. Supple, "The Nature of the Enterprise," in The Cambridge Economic History of Europe, Vol. V, The Economic Organization of Early Modern Europe. ed. E.E. Rich and C.H. Wilson, (London: Cambridge, 1977), 424; Similarly, Wallerstein first acclaims Wilson for insisting, "throughout his corpus of writings on the Netherlands" that Holland was industrialized. He quotes Wilson: "It is sometimes suggested that the Dutch Republic was a purely commercial economy that somehow failed to change gear into a phase of industrialism." See Wallerstein, The Modern World-System, 42, n.32. Actually, Wilson writes industrialization. C.H.Wilson, The Dutch Republic (New York: McGraw-Hill, 1968), 30. But a phase of industrialization can very well be understood to mean manufacture. And, in conjunction with Wilson's other work this lone statement can hardly be construed to mean that Wilson thinks that capitalist industrialisation had occurred.

The supremacy of merchant capital in and of itself became the stumbling block to capitalist development.[11] The inherent contradictions of merchant capital in its period of dominance undermined the country's commercial hegemony. The decline in trade led to the deterioration of the manufacturing sector. In a world economy where manufacturing superiority was slowly but surely taking precedence over commercial dominance, the inability of commercial capital to adapt to changing circumstances led to its transformation into finance capital - financiers chose to invest their money in areas where high interests rates provided high returns without a direct involvement in the production process. Finance capital's predominance in eighteenth century Dutch Republic was not the cause of the decline of Dutch hegemony, as Gilpin argues,[12] but the result of the decline of commercial capital.

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[10] Mooers, The Making of Bourgeois Europe, 16.

[11] For historical evidence to support this contention see C.H Wilson, "Trade, Society and the State" in The Cambridge Economic History of Europe. Vol IV, The Economy of Expanding Europe in the Sixteenth and Seventeenth Centuries, ed. E.E. Rich and C.H. Wilson (Cambridge, London: Cambridge, 1967), 490-492; Max Barkhausen, "Government Control and Free Enterprise in Western Germany and the Low Countries in the Eighteenth Century," in Essays in European Economic History ed. Peter Earle (Oxford: Clarendon, 1974), 244-245; Fernand Braudel, The Wheels of Commerce: Civilization and Capitalism 15-18th Century (London: William Collins, 1982), II, 366; Wilson, The Dutch Republic, 31.

[12] Robert Gilpin, U.S Power and the Multinational Corporation: The Political Economy of Foreign Investment (London: Basic Books, 1975), 8.

Section III

Merchants' capital exercised commercial hegemony in the East Indies during the two centuries that it dominated the Dutch economy. In 1602, the Dutch Republic's national decision making assembly, the States-General, created the "De Verenigde Oost-Indische Compagnie (The United East India Company or V.O.C.).[13] In establishing the VOC, the Dutch States-General was not guided by raison d'etat or mercantilist considerations.[14] As Heckscher aptly remarks, Dutch development was "an anti-thesis of mercantilism."[15] Sir Temple's much celebrated accusation that the Dutch state pursued a policy of mare liberum in Europe and mare clausem in the east was misplaced.

The Dutch state did not have the territorial authority or power to grant the VOC a monopoly in the East Indies. It could only limit competition among Dutch merchants and provide the VOC with the wherewithal to enhance its control over the East Indies trade. It was up to the VOC to determine how it would enhance its profits from trade, through monopoly or by other means. Other European states were free to create merchant monopolies with similar powers. The mere creation of a company monopolizing the Dutch end of the business did not inherently restrict foreign competition. Rather, the Dutch merchants in the late 16th and 17th century were strong advocates of free trade and had used the idea of free trade as an ingenious device to capitalise on the weakness of other European merchants. The Dutch state's support for free trade is evident from the liberal policy on the export of bullion.[16]

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[13] For good discussions of the formation and internal organization of the Company see George Masselman, The Cradle of Colonialism (New Haven and London: Yale University Press, 1963), 133-171; see also Eli F. Heckscher, Mercantilism vol.1 (London: George Allen & Unwin, 1935), 356-373.

[14] It is commonly held that the East India company was the product of mercantilist considerations. See for instance, Joel S. Kahn, "Mercantilism and the Emergence of Servile labour in Colonial Indonesia," in The Anthropology of Pre-Capitalist Societies ed. Joel S. Kahn, (London and Basingstoke: Macmillan Press, 1981), 57-88; Hekscher argues that the, "principal reason behind its formation was probably the endeavour to establish a common front against Spain and Portugal." Heckscher, Mercantilism, 361. He also holds that the monopoly was a paradoxical phenomenon because he finds its cause in mercantilism. Ibid., 359. In the words of one scholar, "The foundation of the United East India Company was primarily meant as a political act by the Dutch authorities." Richard Z. Leirissa, "The Dutch Trading Monopolies," in Dynamics of Indonesian History ed. Haryati Soebadio and Carine A.du Marchie Sarvaas (Amsterdam: North-Holland, 1986), 190.

[15] Heckscher, Mercantilism, 353.

Further, once the States-General established the VOC, it made no attempt to intervene in the affairs of the Company, nor did it have any representation on the 17 member Board of Directors. Even though it had the power to resolve disputes among the Board of Directors, it never exercised this authority.[17]

The VOC Charter was not a mercantilist but a commerce-empowering document;[18] only one clause empowered the company to make treaties with the local potentates in the name of the States-General. Ironically, it was this clause that was used most frequently by the company amidst protests from various European powers. In pursuit of its commercial interests, the company did eliminate foreign competition by making use of its right to make treaties. In pursuit of its commercial ethos, it sought to control demand and supply and to organise production, albeit in a limited way.[19]

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[16] M.A.P. Meilink-Roelosfsz, Asian Trade and European Influence (Hague: Martinus Nijhoff, 1962), 194.

[17] For an excellent discussion of the strategies used by the Gentlemen Seventeen to monopolize the Dutch end of the business see Kristof Glamann, Dutch Asiatic Trade 1620-1740 (Copenhagen, Denmark: Danish Science Press, 1958).

[18] Om Prakash, The Dutch East India Company and the Economy of Bengal, 1630-1720 (Princeton: Princeton University Press, 1985), 10.

The VOC's basic objective was to capture the European spice market. To this end, it entered into treaty agreements with the native rulers to achieve rights to cash crop production by promising the rulers protection from the Portuguese. The very act of signing these treaties with the rulers was based on the twin assumptions that the whole of the Orient including Indonesia were characterised by an Asiatic mode of production with Oriental Despotism. The ruler had complete control over land and the proceeds of production.[20]

Parodying the officials of the English East India Company, Anquetil Dupperion, a scholar of Zoroastrian and Vedic sacred texts, wrote, "Despotism is the government in these countries where the sovereign declares himself the proprieter of all goods of his subjects: let us become that sovereign and we will be master of all the lands of Hindustan."[21] The VOC built its edifice upon this legal fiction, that the native ruler was a despot who had absolute property rights and the peasantry had none. It was the basis of Marx's Asiatic mode of production thesis. It was the foundation for the idealized, autonomous, closed, self-sufficient village in which property was communally owned and everyone was equal. These were myths or at best gross misconceptions. What was preserved was this fiction, while property rights were changed dramatically.[22]

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[19] Meilink-Roelosfsz, Asian Trade; Masselman, Cradle of Colonialism, 422-23.

[20] Meilink-Roelosfsz, Asian Trade.

[21] Anquetil-Duperron, Legislation Orientale, (1778), 178 cited in Perry Anderson, Lineages of the Absolutist State (London: New Left Review, 1974), 385-386.

[22] For the discussion of property rights and state/society relations in the indigenous state systems, I have relied primarily on the following works: J.C. Heesterman, "State and Adat," in Two Colonial Empires ed. C.A. Bayly and D.H.A Kolff, Comparative

The assumption about the Asiatic mode of production was not valid in the case of the East Indies: the peasants controlled their land and used to sell their crop directly to the merchants. It was, however, in the interests of the VOC to encourage the myth and work on its basis. It is far easier to deal with a few weak rulers by cajoling, subjugating, flattering, threatening and corrupting them than to deal with hundreds of thousands of peasants. And barring a few, most native rulers naturally felt elated at the thought of greater prestige and wealth, albeit in subordinate association with the Dutch.[23]

Studies in Overseas History Series ed. H.L. Wesseling (Dordrecht: Martinus Nijhoff, 1986), 189-202; R.E. Elson, Javanese Peasants and the Colonial Sugar Industry: Impact of Change in an East Java Residency - 1830-1840 (Singapore: Oxford University Press, 1984), 10-19; R.E. Elson, "Aspects," 57-82; M. Hoadley, "Slavery, Bondage, Dependency in Pre-Colonial Java: the Cirebon-Priangan Region, 1700," in Slavery, Bondage and Dependency in Southeast Asia Anthony Reid ed. (New York: St.Martin's Press, 1983), 90-117. Anthony Reid, " 'Closed'and 'Open' Slave Systems in Pre-Colonial Southeast Asia," in Slavery, Bondage and Dependency in Southeast Asia Anthony Reid ed. (New York: St.Martin's Press, 1983), 158.

[23] The most notable example of such resistance is three-quarters of a century long rivalry between the VOC and successive rulers of Maccassar, who enjoyed naval and military superiority over the Dutch in the first half of the seventeenth century. Located in Sulawesi, the kingdom of Macassar was the spice and slave entrepot of the East Indian archipelago where merchants from East and West came to acquire their supplies. Reiterating the doctrine that the seas should remain 'free and open to all', a principle that Grotius had expounded in The Freedom of the Seas or the Right that Belongs to the Dutch to Take Part in the East Indian Trade, King Allaudin, who ruled Macassar in the first half of the seventeenth century, declared, "God has made the earth and the sea, has divided the earth among mankind and has given the sea in common. It is a thing unheard of that anyone should be forbidden to sail the seas." As a result, in the Treaty of 1637, the VOC recognized the Macassarese maritime rights. Forty years later, on the signing of the treaty of "ugly peace", when King Allaudin refused to stop trading with the Spice Islands, he queried the VOC officials, "... do you believe that God has reserved these islands, so far away from the place of your nation, for your trade alone?" F. W. Het Staple, "Bongais verdag: De vetiging der Nederlanders op Makassar" [The Boggaya Treaty: the Establishment of the Dutch in Makassar]. (Ph.D Diss., University of Leiden, 1922) 14, n.2. cited in G.J. Resink, Indonesia's History Between the Myths: Essays in Legal History and Historical Theory (The Hague: W.van Hoeve, 1968), 45-46. Macassar was conquered in 1668.

The propagation and practice of the myth that the ruler was master of all he surveyed was obviously advantageous to the VOC as the overlord and later to the Dutch state when it acquired the VOC, to grant concessions to Dutch and other foreign capitalists. Between 1642 and 1681, the VOC entered into several agreements with the native rulers, who recognised the VOC as overlord with promises of tribute, assured deliveries of produce fixed by and to the advantage of the company, and monopoly over their exports and imports.[24] The company met with remarkable success. In the short time between 1605 and 1621, the company gained monopoly control over the production of mace, nutmeg, and cloves in the islands of Ambionia, Ternate and Banda.[25] And the company paid the peasants almost 25 percent less for pepper, which constituted 50 percent of Dutch trade in the mid-seventeenth century, than they had previously received.[26] The VOC also gained a substantial share of the import market in the islands it subjugated, particularly over textiles, opium, and food products.[27] Fixed, unequal, monopsonistic rates were set to exchange export commodities for Indian textiles or food that the company imported.[28]

The peasants on islands such as Banda and Ternate who had previously depended on imports from foreign lands were left forced to accept the company's high priced goods. The company used restrictive practices such as destruction to thwart the indigenous fabrication of textiles and cotton cultivation.[29] Through its monopoly over the textile trade, the VOC prevented the emergence of indigenous textile handicrafts in those areas where the natives had previously been involved in producing their own cloth, at least for the duration of its existence.[30]

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[24] Meilink-Roelosfsz, Asian Trade, 195-196, 211-213, 219. Masselman, Cradle of Colonialism, 422-23; Heather Sutherland, "Slavery and the Slave Trade in South Sulawesi,1660s-1800s," in Slavery, Bondage and Dependency in Southeast Asia ed. Anthony Reid (New York: St.Martin's Press, 1983), 268; Prakash, East India Company, 14 n.19, 15-16.

[25] Meilink-Roelosfsz, Asian Trade, 211.

[26] Ibid., 214.

[27] For the details regarding specific textile related treaties signed with the native rulers see Om Prakash, East India Company, 142-143.

[28] Meilink-Roelosfsz, Asian Trade, 213.

An academically interesting but otherwise pathetic circumstance is portrayed in the case of clove cultivation. The company entered into agreements with the rulers of Tidore, Ternate, and Bacan. In return for pensions these rulers allowed the company to send expeditionary forces annually to destroy the clove trees.[31]

The regressive character of merchant capital is also brought into sharp relief by changes which ensued in the Cirebon-Priangan region after coffee became a major source of revenue for the VOC. In the habit of limiting supplies to maximise profits, the company arrogated the monopoly of coffee production in 1723 and then proceeded to restrict coffee production by destroying coffee plants and reducing the prices paid to the native peasants.[32]

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[29] The proportion of textiles in the total value of the cargo brought in by the company amounted to was 83.52% in 1659, 84.21% in 1661, 76.22% in 1670, 49.98% in 1681 and 44.62% in 1682. Om Prakash, East India Company, 143, n. 5. Also see Joel Kahn, Minangkabau Social Formations, 157-58.

[30] For a discussion of the contradictions of this policy see Melienk-Roelofsz, Asian Trade, 195-196, 198.

[31] Leirissa, "Dutch Trading Monopolies," 195. Also see Masselman, Cradle of Colonialism, 420. For reduced prices to peasants for clove production see Melink-Roelofsz, Asian Trade, 214.

[32] J.S. Furvinall, Netherlands India: A Study of Plural Society (Cambridge: Cambridge University Press, 1944), 40-45; Bernard H.M. Vleeke, The Story of the

For the East Indies, the consequences of the dominance of merchant capital were disastrous. The company's practices wrested the peasants control over their products. Unable to grow or sell crops freely, the peasants' desire to produce for a profit gradually declined. Furvinall rightly argues that as a necessary consequence, "the economic life of the people was stunted by the suppression of all economic activities but agriculture."[33]

The coffee and clove episodes demonstrate that native peasants were not lethargic nor lacking in initiative. Nor was their interest limited to subsistence production. On the contrary, it was by deliberate design that the VOC prevented the peasant and even the native elite from enjoying the benefits of the cash crop trade. For this reason, the peasants preferred to produce crops for their subsistence or for which there were no restrictions and that could be sold in the open market. Such was their attitude of dumb defiance that when the demand for spices rose in Europe, the VOC's attempt to tempt peasants to raise production met with dismal failure! Consequently, the Dutch failure to meet the European demand enabled the British to sell Indian spices in European markets.[34] How were the peasants to know that their trees and plants would not once again be razed to the ground?

By establishing links through village heads and native rulers with the peasants, the VOC was responsible for the shrinking role of the native merchants. And if there is some strength to the arguments of marxist and other thinkers in the liberal persuasion, that the growth of merchant capital creates one of the necessary conditions for the growth

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Dutch East Indies (Cambridge, Mass: Harvard University Press, 1946), 114.

[33] Furvinall, Netherlands India, 45.

[34] Vleeke, The Story, 121.

of industrial capitalism, then the VOC's terrorising techniques effectively prevented the growth of such industry. The only class which this system encouraged was a class of rentiers, a class of functionless drones who obtained pensions and royalties without performing any productive functions.

Section IV

Hilferding, followed by Lenin, observed that imperial states intensified their policy of territorial annexation and colonization in the age of finance capital. The historical circumstances obtaining in the 19th century Dutch Republic rebut the general applicability of their thesis. The eighteenth century Dutch financier was not Hilferding's petty usurer of the pre-industrial age.[35] Fulfilling the needs of industrial capital abroad, the Dutch financier was involved in the activities of his industrial age counterpart.[36] But this class nearly disappeared as a consequence of the French revolutionary and

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[35] Hilferding distinguishes between pre-industrial and post-industrial financial capital. He defines pre-industrial financial capital as usurer's capital. However, pre-industrial Dutch financial capital did display the characteristics that Hilferding attributes to post-industrial financial capital. Hilferding writes:

> I call bank capital, that is, capital in money form which is actually transformed in this way into industrial capital, finance capital. So far as its owners are concerned, it always retains the money form; it is invested by them in the form of money capital. But in reality the greater part of the capital so invested with the banks is transformed into industrial, productive capital(means of production and labour power)and is invested in the productive process. An ever increasing proportion of the capital used in industry is finance capital, capital at the disposition of the banks which is used by the industrialists. Rudolph Hilferding, Finance Capital (London: Routledge & Kegan Paul, 1981), 225.

[36] The Dutch financed a large proportion of the growing world trade and lent capital to the expanding economies of Europe. C.H. Wilson, "The Historical Study of Economic Growth and Decline in Early Modern History," in The Cambridge Economic History of Europe ed. E.E Rich and C.H. Wilson Vol 5. The Economic Organization of Early Modern Europe (Cambridge, London: Cambridge University Press, 1977), 5.

Napoleonic wars. As a result: it was neither in a position nor willing to finance Dutch industrialisation. Thus, it was in the epoch of the decline of financial capital rather than during its age of glory, and not at its behest, albeit with its support, that the Dutch state intensified its control over the East Indies.

To meet this challenge/deficiency, the Dutch state pursued a policy of mercantilism to finance industrialisation. An important aspect of this policy was to generate surplus from the East Indies. With this objective, in 1830 the colonial state adopted a policy that came to be known as the Cultivation System or Culture System. The Cultivation System had two basic objectives: first, to realise huge quantities of cheap commercial crops to be sold on the Amsterdam market to revive the Dutch economy and to fill the state treasury; second, to transform the East Indies into a stable market for the Twente textile mills in the Netherlands which were promoted and protected by the state.[37] From the perspective of the Dutch state, this policy met with admirable success. Both goals had been achieved when the Cultivation System came to an end in 1870. Batavia had remitted 823 million guilders to the Dutch treasury between 1831 and 1871.[38] In the 1850s, 31% of the Dutch state's revenue came from the sale of East Indian commercial goods.[39] Amsterdam had been restored as the centre of the spice trade.[40] In the reverse direction, the sale of cheap Dutch and English cotton textiles had increased and were superseding local production.[41]

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[37] Furvinall, Netherlands India, 116.

[38] D.K.Fieldhouse, The Colonial Empires: A Comparative Survey from the Eighteenth Century (Basingstoke: Macmillan, 1982), 333.

[39] C. Fausser, "Some remarks on the Culture System in Java," Acta Historica Neerlandicae, 10 (1978), 155 cited in Dharma Kumar, "The Taxation of Agriculture in British India and Dutch Indonesia," in Two Colonial Empires C.A. Bayly and D.H.A Kolff ed. (Dordrecht: Martinus Nijhoff, 1986), 211.

Although properly speaking, the Dutch Republic had acquired the V.O.C's territories as a commercial transaction[42], the Cultivation System derived its legitimacy from the idea that the Dutch state was sovereign. As indicated above, the VOC had acted on the premise that in the East Indies, the ruler was master of all land. The VOC had assumed this role for itself and it was to this role that the Dutch state succeeded. The Dutch state arrogated to itself the legitimate rights of native rulers, who normally took one-fifth of the produce in kind.[43] The colonial state, on the face of it, simply accepted this position. In practice in the process of implementation, major structural changes occurred. The romanticized autonomous village cooperative was born for the administrative convenience of the colonial government.[44]

The nature of the produce and its output were determined by the state. Peasants were to allocate one-fifth of the irrigated rice land for cash crop cultivation, provide 66 days labour to cultivate, process and transport the commercial crops such as coffee, indigo, and sugar and finance the delivery to government store-houses. The value of the cash crops produced by each village was calculated to guarantee that it received adequate funds to pay its taxes which typically equalled the "land rent assessed on a single rice crop" while ensuring that after deducting processing and distribution costs the government realized a competitive world market price.[45] To be fair to the devil, if the colonial government realised extra money, it would return it through the village heads.[46] Unfortunately this money rarely, if ever, reached the cultivator.[47] To ensure compliance, the native chiefs and their assistants were given a percentage of revenues and vast and arbitrary coercive powers. This gave them power, prestige and wealth.[48]

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[40] Fieldhouse, Colonial Empires, 333.

[41] C. Fasseur, "The Cultivation System and Its Impact on the Dutch Colonial Economy and the Indigenous Society in Nineteenth-Century Java," in Two Colonial Empires ed. C.A. Bayly and D.H.A Kolff (Dordrecht: Martinus Nijhoff, 1986), 144-145.

[42] The United East India Company had been dissolved and the state had acquired it for the paltry sum of 140 million guilders. E.H. Kossman, The Low Countries, 1780-1940 (Oxford: Clarendon Press, 1978), 163.

[43] Dharma Kumar, "Taxation of Agriculture," 208-209.

[44] J.C. Heesterman, "State and Adat," 189.

Whether the system was just a continuation of the traditional "adat" law, as some scholars have argued, or even more burdensome and unjust, as I believe, need not detain us. Nor is it useful to partake in the argument, popular with neo-marxist scholars, that indigenous capitalism would have developed in Indonesia if imperialist intervention had not occurred. These "ifs" and "buts" of history are too speculative to aid historical explanation and do not serve any purpose. The main argument is that until the end of the 1860s and even later, the conditions for the development of industrial capitalism did not exist in Indonesia.

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[45] R. van Niel,"The Function of Land Rent under the Cultivation System in Java," Journal of Asian Studies 23 (1964), 365.

[46] Van den Bosch aimed to pay individual sugar planters the actual value of the sugar produced, not an estimate of what government officials anticipated the cane would yield. R. van Niel, "The Effect of Export Cultivations in Nineteenth Century Java," Modern Asian Studies 15 (1981), 41. Although this principle was adopted in the Probolinggo residency in the 1830's, it was not implemented in the Pasuruan region until the 1850's. Elson, Javanese Peasants, 60-61. In August 1832 Bosch decreed that the coffee producers be paid directly and immediately instead of receiving their share of coffee payments from the village headman. Robert Van Niel, "Measurement of Change under the Cultivation System in Java: 1837-1851," Indonesia (October 1972), 99.

[47] In 1834, 22319 landholding sugar planters were required for cultivating 4891 hectares of cane for which they received f311201 in crop payments. By 1851, only 18369 planters were subject to cultivation duties on an area of 5138 hectares of cane, for which they received f519119.13. See R.E. Elson, "The Cultivation System and 'Agricultural Involution'," Working papers series no.14. (Monash: Monash University, 1978), 28.

[48] Elizabeth Graves, The Minangkabau Response to Dutch Colonial Rule in the Nineteenth Century Monograph Series No. 60, Cornell Modern Indonesia Project, (Cornell University, Ithaca: New York, 1981), 61; see also Elson, Javanese Peasants, 80.

Section V

While the Cultivation System was in full swing in the East Indies, bringing major benefits to the Dutch state and capital, the gusty winds of European laissez-faire liberalism, with its epicentre in France and Britain, to which the notions of free contract, wage labour, and private enterprise were integrally tied, shook the Netherlands during the 1850s and 1860s. They also touched the East Indies, although their impact obviously was not and could not have been the same as in the Netherlands or in the rest of Western Europe. The Cultivation System and laissez-faire liberalism were incompatible.

Although it was the East Indies which primarily suffered from the impact of the Cultivation System, it was attacked by various quarters in the Netherlands: humanitarian liberals, doctrinaire liberals and the conservatives.[49] The humanitarian liberal position was best exemplified by two lone voices in the late 1840s onwards. P.J. Veth, the professor of Hebrew at Amsterdam University, founded a monthly which constantly reminded its readers of the debt of the Netherlands to its East Indies subjects. Then there was Baron W.R. van Hoevell, a minister of the Reformed Church in Batavia.[50] He sought to persuade the Governor-General to institute mild reforms in Java, but only succeeded in ruffling him and returned to the Netherlands to continue his crusade against the evils of the Cultivation System.

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[49] Kossman, The Low Countries, 275-276; For a detailed analysis of the conservative faction in the Netherlands see Ibid., 274-288; Hermann van der Dunk, "Conservatism in the Netherlands," Journal of Contemporary History 13 (1978), 741-63; In the 1840s the doctrinaire liberals were led by Johan Rudolph Thorbecke, a professor of jurisprudence at Leiden University. He remained a dominant figure in Dutch politics until his death in office in 1872, after holding the post of Prime Minister three times on an intermittent basis. The 1848 constitution was his brain child. Doctrinaire liberalism was elitist. For further information about Thorbecke and the 1848 constitution see Kossman, The Low Countries, 188-195.

The publication of Dekker's heart-rending novel Max Havelaar in 1860 sent a chill through the Netherlands.[51] The moral of his story was used to rally support for laissez-faire liberalism in the East Indies by the new crop of liberals, the planter liberals, of whom van de Putte was the epitome.[52] "He was a very different man from Thorbecke or van Hoevell and had nothing in him doctrinaire or humanitarian".[53] After a fruitful career as a sugar planter in the East Indies, van de Putte, "a practical man of business"[54], wrote a pamphlet called Sugar Contracts in which he denounced the "unrighteousness" of the Cultivation System.[55]

Van de Putte and Thorbecke had fundamental differences about the question of landownership in the East Indies. Reflecting his political naivete, Thorbecke chose van de Putte as his colonial minister in 1863; he immediately began to draft legislation which "aimed to give both capitalist and cultivator full and free disposal of land and labour for private enterprise."[56] From Putte's perspective, Thorbecke - the grand old man of the 1840s and 1850s, was a mite too conservative.

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[50] Hoevell did not oppose the extraction of profits from the East Indies, for and by the state.

[51] Dekker had served the colonial government from 1838 to 1856 when he resigned after a conflict with his superiors.

[52] Furvinall, Netherlands India, 161-62.

[53] Ibid.

[54] Ibid., 163.

[55] Ibid.

Policy differences between the two men led to Thorbecke's resignation in 1866. As the new Prime Minister, Putte introduced his legislation which was defeated by Thorbecke and a coalition of doctrinaire liberals, Catholics, and conservatives. Van de Putte resigned and the property ownership issue was shelved for a few years as the conservative Colonial Minister Mijer sent reassuring signals to the native chiefs on Java that their property rights would be safeguarded. Soon he became Governor-General and the conservatives, already sapped of much of their strength, were left without a policy and a leader. The conservatives and the doctrinaire liberals had been influential enough to block the legislation for a few years and to ensure that certain suitable amendments were made to Putte's bill.

But they could not stop the floodgates of laissez-faire liberalism from bursting.[57] Indeed, it was conservative colonial minister de Waal who gave shape to the Agrarian and Sugar laws which signalled an unmitigated victory for Putte's laissez-faire liberals. The new legislations brought freedom and security for private enterprise while the doctrinaire liberals and conservatives had to find satisfaction in the fact that native tenures were "assured".[58]

The demolition of the Cultivation System began in 1862 as a number of crops were opened up to private enterprise. In 1870 the passage of the Sugar Law dealt the final blow to the Cultivation System bringing the colonial government's sugar monopoly to an end. The Agrarian Law of the same year abolished "communal" landownership in the East Indies and created "private ownership" for the peasant. With the Rent Ordinance of 1871, peasants were at last "free" to rent their land for a fee and to hire their labour for a wage. The legislations created the conditions for the establishment of large plantations by native and Dutch entrepreneurs. Theoretically, of course, the legislation was non-discriminatory in so far as the natives were also entitled to the benefits of this legislation. In practice, however, it was intended to help Dutch planters.[59]

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[56] Ibid., 164.
[57] Ibid., 164-165.
[58] Ibid., 161-65.

The Agrarian Law gave private enterprise access to land and labour while theoretically safeguarding native property rights. The law legally recognised the state's proprietorship over land, including the land held in village commons. But it excluded privately owned land which was not subject to any restrictions. Land held under customary tenure by the peasant whether divided communally by the VOC or under the Cultivation System or the land governed by adat law became unfree state land. The rest of the land, including wasteland or land and resources which the peasants used according to need and in which they had a stake but no proprietary rights, became "free" state land. The state could lease this land to Dutch subjects, inhabitants of the Dutch East Indies, or to companies registered in the Netherlands.

But the Agrarian Law was a general law and did not specifically deal with the question of subsoil rights. Under van de Putte's direction, the Declaration of 1874 and the Declaration in XVII Articles of 1873 were passed. They were based on the Agrarian

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[59] Ibid.

Law of 1870 and the Mining Ordinance of 1873. Section 571 of the Civil Code, which gave the surface owner the right to the products of the subsoil,[60] was re-interpreted to give the colonial government the authority to expropriate the land of an unwilling or incapable owner in return for "just" compensation.[61] And with the Declaration in XVIII Articles the Dutch government's interests superseded the wishes of the East Coast rulers who had to secure the colonial government's permission to grant concessions.[62] But these two latter regulations fell into disuse until the end of the 19th century so that private enterprise significantly contributed to the East Coast's vitality.[63]

The new arrangements thus served the interests of private enterprise. Since the conditions for native private enterprise did not exist, had not been created during the previous centuries, and in fact what conditions had existed had been retarded during these centuries, the floodgates to private European private capital could be opened. It was now possible for Dutch producers to control the entire production process from the cultivation of crop/extraction of minerals to their final sale. Interesting examples in this connection were the case of sugar in Pasuruan in East Java and tobacco in the native kingdom of Deli.

Despite the rhetoric of laissez-faire liberals, Dutch producers in the Pasuruan region continued to use the coercive power of the state to obtain labour and cane supplies.[64] District regent Mas Atmowiyogo warned the unwilling peasants of a cluster of villages in the Pajarakan district of Probolinggo that the Cultivation system would be restored if they refused to work for and hire their land to the sugar planters. As a reward for "influencing" the villagers to surrender their land, every factory paid the village chief a certain premium for every bahu of land.[65]

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[60] Frederick C. Gerretson, History of the Royal Dutch, vol. 1 (Leiden: E.J. Brill, 1953-57), 49.

[61] Ibid., 51-53.

[62] Jan Berman, Taming the Coolie Beast: Plantation Society and The Colonial Order in Southeast Asia (Delhi: Oxford University Press, 1989), 20; Karl Pelzer, Planter and Peasant: Colonial Policy and Agrarian Struggle in East Sumatra, 1863-1947 (The Hague: Martinus Nijhoff, 1978), 69-70.

[63] Berman, Taming the Coolie, 13.

Similarly, in the case of the development of capitalist enterprises in the tobacco plantations in the Kingdom of Deli in Sumatra, concessions were granted on the basis of the legal fiction already discussed that the rulers were the real owners of land and could dispose the property of the subjects as they saw fit. The native rulers were easy prey. They had previously maintained a modest life-style. They were now much better off. They became wealthier, more powerful and enjoyed status with the concessionaires.[66] The Model Contract of 1878 established that the local rulers would be paid one guilder per bahu of land and leases were standardised for seventy-five years. In the process they became a class of rentiers par excellence and had no incentive or inclination to seek new avenues such as entrepreneurial roles in industry or banking.

Thus in its application to the East Indies, laissez-faire liberalism simply implied that the colonial state permitted Dutch private planters and miners to feel free to come to Indonesia. It would not protect the natives from the onslaught of more powerful Dutch capital.

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[64] Free labourers were twice as expensive as unfree peasants. In 1879, 91% of the sugar cane harvested in Pasuruan area was grown on government administered land. Elson, Javanese Peasants, 128-129.

[65] Ibid.

[66] The Sultan of Deli yielded to Dutch authority in 1862. In return, the colonial government recognized Deli as Siak's equal, and several adjoining principalities as its dependencies. The colonial government treated the less compliant rulers of Serdang and Asahan as inferior to the Sultan of Deli until they too yielded in 1865, after periodic Dutch intimidation. Berman, Taming the Coolie, 18-19.

Part II

This part discusses colonial mining policy. The dominance of the large international petroleum companies in Indonesia's petroleum industry was primarily the product of the structural conditions characterising that industry. Within the parameters of the possible, the colonial state created the groundwork for bargaining between the oil majors and the post-independence Indonesian state.

When Indonesia gained independence the large oil multinationals were firmly established in Indonesian territory. This was a colonial legacy. But before it left, the colonial state had also renegotiated the concessionaires' terms of operation. When Zjilker, the progenitor of Royal Dutch, had signed his first concession, the colonial state's participation had been limited to that of regulator. The native ruler had been the concessionaire's rentier.

But the colonial state's desire to enhance its revenues emerged ever since the Royal Dutch became a commercially viable enterprise, producing petroleum in commercial quantities. Consequently, as bargaining specialists are wont to argue, the state sought to change the original terms of the concession in its favour.[67] In 1921 the colonial state signed a 50/50 profit-sharing arrangement with Royal Dutch/Shell.

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[67] Theodore H. Moran, Multinationals and the Politics of Dependence: Copper in Chile (Princeton: Princeton University Press, 1974), Chapter 6; Raymond Vernon, Sovereignty at Bay: The Multinational Spread of U.S. Enterprises (Harmondworth: Penguin Books, 1973; Basic Books, 1971), 53-60.

The state centralised control over petroleum operations. It legislated the state's sovereign rights to subsoil minerals, the strategic importance of petroleum, a 50/50 profit-sharing arrangement that had as yet not been achieved in other petroleum-producing countries, and the state's rights to actively pursue petroleum exploration and production in collaboration with the large oil transnationals. In achieving centralised control the state had relieved the native rulers and peasants of their surface and subsoil rights, rights that the post-colonial state would probably have arrogated if the colonial state had not already accomplished this objective.

As bargaining specialists argue, irrespective of the political predilections of a state's decision-makers, there is a propensity to renegotiate the terms on which the original concessionaire entered the unknown petroleum terrain of an oil-producing country after commercially producible quantities of petroleum become known or available. Then the state decision-makers and the cognizant public begin to feel cheated.[68]

The bargaining literature has concentrated on the relationship between host countries and foreign mineral-producing companies. But for this sense of injustice to exist, the private enterprise does not have to be foreign in origin. This was evident from the furore surrounding the renewal of the Billiton concession. It brought down Governor-General s'Jacob's, a former tobacco planter, who had renewed the Billiton concession ten years before it was due to expire on extremely advantageous terms without consulting parliament.[69]

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[68] Raymond F. Mikesell, "Conflict in Foreign Investor-Host Country Relations: A Preliminary Analysis," in Foreign Investment in the Petroleum and Mineral Industries ed. Raymond F. Mikesell (Baltimore: John Hopkins, 1971), 39.

This was the beginning of a sense of injustice within the Dutch state and society about being cheated out of rich revenues by a mineral producing company. When the state and other groups in society see rich profits accruing to private enterprise that could accrue to the state, then the state seeks to renegotiate the terms of the original concession. If that does not seem feasible then the state will seek to change the terms under which new concessions will be granted.

> A pronounced change in outlook can be expected to occur, however, after the initial exploration has been completed. The projects that fail drop out of sight. ...The projects that succeed take the limelight; what was once a wistful hope becomes a tangible bonanza. ...The returns to the foreign company no longer seem appropriate to the risk, and the government feels justified in demanding more out of the project.[70]

This was true of Dutch decision-makers. A majority of parliamentarians believed that increased state control and a greater share of rent from the oil industry were in the national interest. The decline of laissez-faire liberalism in Europe at the turn of the 19th century and in the beginning of the 20th century, the growing ascendancy of socialism, and a belief in an activist role for the state aided this process.[71]

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[69] Furvinall, Netherlands India, 326.

[70] Vernon, Sovereignty at Bay, 55.

[71] Reed exaggerates the influence of the socialists by giving them undivided credit for demanding and achieving greater state control over the Dutch East Indies oil resources. He assigns sole responsibility to the socialist leader Alberde for the defeat of the 15 March 1915 bill introduced by Pleyete, the Minister of Colonies, which aimed to grant the rich Djambi concession to De Bataafsche Petroleum Maatschaapij (B.P.M), Royal Dutch's producing and refining subsidiary. He also holds the socialist faction responsible for rejecting van Indenberg's 17 November 1917 bill, whereby B.P.M. and the

In an impassioned speech Van Kol, the Socialist Deputy in the Dutch parliament exclaimed, "all the resources of the subsoil belong to the community and must be subservient to the public weal."[72] He also argued that the state, not private enterprise should develop the natural resources to maximise the public advantage. Even Jacob Theodoor Cramer, the Minister of Colonies, an avowed liberal who had made a fortune on Sumatra's tobacco plantations at the rather tender age of thirty-four declared, "where an expert investigation set up by the State proves the great likelihood of profitable development, the Government would consider it at variance with the interest of the country to issue concessions."[73]

The state can claim ample economic rents from mineral resource extraction when it holds title to mineral and subsoil rights.[74] Its power derives from sovereignty, from

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government would operate the concession jointly through a new company, the Nederlandsche Indie Aardolie Maatschaapij. Reed speculates that the socialists may also have caused the suspension of the mining law in 1913. Peter Mellish Reed, "Standard Oil in Indonesia, 1898-1928," Business History Review 32 (1958), 316-317. In the first two decades of this century, Dutch secular political parties were generally considered to be on the left of the political spectrum; religious parties on the right. For a general but good summary of political developments during this period see Kossman, The Low Countries, 473-516, 545-560. In the polls the leftist political parties fared poorly compared to those on the right. Although they did not adopt a unified political stance on all issues, the Christian parties dominated the States General with 58 seats in 1901, 48 seats in 1905, 60 seats in 1909, and 45 seats in 1913. Ibid., 477-78. In contrast, in 1913, out of a total of 100 seats in the States General, the socialists had 15 seats; in 1918, 22 seats. Ibid., 477-78, 556. The socialists obviously did not have enough seats in the legislature to defeat a bill on their own, although they had gained considerable political ground towards the end of the nineteenth century and in the early decades of the twentieth century.

[72] Frederick C. Gerretson, History of the Royal Dutch, vol.2 (Leiden: E.J. Brill, 1953-57), 311.

[73] Ibid.

[74] Gertrud G. Edwards, "Foreign Petroleum Companies and the State in Venezuela," in Foreign Investment in the Petroleum and Mining Industries ed. Raymond Mikesell

its ability to keep or grant concessions and pen legislation.[75] The Dutch state had first to claim this sovereign right before it could increase its control over the oil industry. To do this it had to deprive native rulers and peasants of their surface and subsoil rights. It had to centralise control over oil concessions and mineral rights to ensure that it, and not the native rulers, would obtain the royalties from oil exploration and production.

The Menten case provided the state with the means to obtain direct control over oil revenues. As early as 1885, regional colonial residents were prohibited from approving concessions. Renaud, the Head of the Colonial Mines Department, a strong advocate of state ownership and development, and greater rents for the state, began to enforce the 1873 Mining Ordinance.[76]

In 1888 Jacobus Hurbertus Menten, a government mining engineer, obtained the rights to develop, manufacture, and sell petroleum products for the entire Kutei domain in Borneo from the Sultan of Kutei. In the conservative stronghold of Batavia, Menten's monopoly rights were denounced.[77] But it was a furore against the native rulers rather than a tirade against private enterprise. Now the Sultan's Political Contract of 1864 was invoked which prohibited him from granting concessions to a non-native, a stipulation that had until then fallen into disuse. Indeed, Zjilker had obtained his Royal Dutch concession despite the Political Contract.[78]

The state relieved the native rulers of their power to grant concessions with the

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(Baltimore: John Hopkins, 1971), 140.

[75] Ibid., 121.

[76] Gerretson, Royal Dutch, vol.2., 155-157.

[77] Ibid., 158.

[78] Ibid., 155-157.

Model Contracts of 1899 and the Short Contracts of 1907,[79] which Gerretson describes as a "classical example of administrative annexation."[80] The colonial state did not intend to limit private enterprise but to prevent the native rulers from "fixing not only the conditions for a concession but also its geographical extent."[81]

The Short Declarations of 1907, signed individually with 267 Outer Island native chiefs gave the colonial state the exclusive right to grant exploration concessions. The native rulers, the only natives with the financial resources to become meaningfully involved in exploration and development were transformed into rentiers par excellence.[82] Although the Short contracts were drafted unilaterally, Section 43 of the Amended Statute of 1910, No.588 to the 1899 mining law declared, "the Princes have transferred the right to grant prospecting licences and concessions for exploitation to the government of the Netherlands Indies by agreement."[83]

The 1899 Law made the colonial state regulator and rentier. With sovereign control over all subsoil rights,[84] the state would grant concessions to competent entrepreneurs whose operations would bring the state royalties. It would determine the extent of royalty payments and also the native rulers share.[85] At this juncture the state did not seek to limit the role of private enterprise. Since it did not wish to partake in exploration and development risks, the discoverer was allowed unlimited control over the concession.

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[79] The colonial state revised the Short Contracts in 1919 and 1927 to restore some powers to the self-governing territories. But these changes did not apply to the petroleum industry.

[80] Ibid, vol.2., 158.

[81] Ibid.

[82] Lindblad, "Economic Aspects," 7; for a discussion of the implications of the Short Declarations or Contracts see, Amry Vandenbosch, The Dutch East Indies: Its Governments, Problems, and Politics (Berkeley: University of California Press, 1941), 131-139.

[83] Section 44(1), Act of May 23, 1899 cited in Robert Fabrikant, Oil Discovery and Technical Change in Southeast Asia - The Indonesian Petroleum Industry: Miscellaneous Source Materials, Field Report no.4 (Singapore: Institute of Southeast Asian Studies, 1973), 28.

[84] Vandenbosch, Dutch East Indies, 250.

The state did not seek to renegotiate existing contracts. But it stipulated a paltry increase in rent for new concessions: four percent of gross production and a fixed surface tax for each hectare of the concession area for which the concessionaire derived the right to exploit the concession for forty to seventy-five years.

This was to change soon. In 1901 the state looked enviously at the dividends that Royal Dutch was paying out to its shareholders and was considering means to capture some of those rents for itself. "What are regarded as equitable terms in an unsure milieu for both parties before oil is discovered in commercial quantities are not likely to be regarded as equitable later on."[86]

The state weighs the immediate benefits of exploitation against the possibility of higher future revenues and the lost opportunity cost of capital resulting from postponing the development of mineral resources. When the state is unable to obtain better terms from a concessionaire based on its discount rate calculations or if the state bureaucracy is uncertain about the rents that it can extract from the concessionaire in the present, then the state benefits by postponing the award of new concessions. Freezing concessions can in and of itself enhance the state's bargaining power if a concessionaire is anxious to gain a new concession or a foothold in a country where the existence of petroleum in substantial quantities has been proven. Then the investor will seek to know what it must give the state in return for obtaining a concession.

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[85] Vandenbosch, Dutch East Indies, 132-135; A.L. ter Braake, Mining in the Netherlands East Indies (New York: Institute of Pacific Relations, 1944), 22.

[86] Donald A. Wells, "Aramco: The Evolution of An Oil Concession," in Foreign Investment in the Petroleum and Mineral Industries: Case Studies of Investor-Host Country Relations ed. Raymond F. Mikesell (Baltimore: The John Hopkins Press, 1971), 219.

In 1904 the Dutch state froze grants of new concessions. Also in 1904 the Royal Dutch was the only investor of substance to whom the state could grant concessions in conjunction with the aspirations that it had enshrined in the 1899 mining law. The Dutch state had little choice and the Royal Dutch could still hold the state hostage for the revenues that it was already bestowing to the Dutch treasury. The Royal Dutch was to become the state's prized possession.

Constrained by its own mercantilist considerations, the Dutch state had deliberately foiled Standard's attempts to enter the East Indies market. It was after all the age of inter-imperialist rivalry on a world-scale in which the Netherlands was a humble player. After the First World War, the vital importance of oil would become even clearer to the greater and lesser Western powers.[87]

In the last decade of the 19th century, the Royal Dutch had been but a fledgling company worthy of protection against the mighty Standard which had for long controlled 80 percent of the Netherlands oil trade. Standard had made several bids to acquire the

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[87] Edith T. Penrose, The Large International Firm in Developing Countries (London: George Allen and Unwin, 1968), 57.

Royal Dutch in 1895 and in 1898.[88] As Penrose notes, "It must be remembered, of course, that it was easy, not only in the US but also abroad, to raise fears - not by all means all unjustified - of the 'Standard Oil Monopoly'."[89] How could this monopoly now be allowed to gain a foothold in the rich Indonesian oil fields that represented handsome oil revenues for the Dutch state?

The Moera Enim affair had been the most famous and publicised of these sagas in which the Dutch national interest had come to be identified with the interests of the Royal Dutch. Having failed in its attempts to acquire the Royal Dutch, Standard and the owners of Moera Enim, a Dutch company, conducted negotiations in mid-February 1898.[90]

A wave of nationalism spread throughout the Netherlands as resentment of Standard's acquisitive manoeuvre grew in all quarters. Opponents argued that if the deal went through Standard would wage a war against the Royal Dutch at the expense of the Moeara Enim; preferring to sell American over Sumatran oil, Standard would not develop Moeara Enim's fields enthusiastically. In the process, Moeara Enim's shareholders would be the losers. The press rendered Moeara Enim a traitor. IJzerman, Moera Enim's owner, was portrayed as Macbeth. Public opinion was not far behind. An assault on the Royal Dutch - in which many small investors had a share - was seen as contrary to the general good. Opponents argued that an attack on the industry from which the state derived fifty million florins a year was untenable.

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[88] Harold F. Williamson and Arnold R. Daum, The American Petroleum Industry: The Age of Illumination, 1859-1899, vol.1 (Evanston:Northwestern University, 1959), 675. Also see Mira Wilkins, The Emergence of Multinational Enterprise: American Business Abroad from the Colonial Era to 1914 (Cambridge, Mass: Harvard, 1970), 84.

[89] Edith T. Penrose, The Large International Firm, 57.

[90] Gerretson, Royal Dutch, vol.2, 60-61.

> While great losses are being sustained in sugar and coffee, while agriculture is languishing and our industry is hard put to it in its struggle against the competition of surrounding protectionist countries, it is a blessing for our country that tobacco and petroleum, at any rate, bring millions and millions from which the inhabitants derive profit, including the Minister of Finance in his capacity as a tax-gatherer.[91]

What a paradox it was that the people of an imperial country should fear domination and yet promote it; and firmly assert their claims to the fruits of the earth in territory where their government had suppressed similar claims so effectively. At the turn of the 19th century, there were eighteen companies exploring for or producing oil in various parts of the East Indies, prominently in North and South Sumatra, central and eastern Java and East Borneo. By 1912, Royal Dutch-Shell had swallowed the Dordtsche Petroleum Company, the last independent producer.[92] With the state's blessings the Royal Dutch, which became Royal Dutch/Shell in 1907, had become a fully integrated corporation with monopoly control over Dutch East Indian petroleum production and pricing until Standard's formal advent into the East Indies in June 1925.[93]

Royal Dutch created the Committee of the Netherlands Indies Producers and the

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[91] Ibid., 66.

[92] Anderson B. Bartlett III, R.J. Barton, J.C. Bashlett, G.A. Fowler, Jr., and C.F. Hays, Pertamina: Indonesian National Oil (Jakarta: Amerasian, 1972), 44-45; see also Reed, "Standard in Indonesia," 314; Irvine H. Anderson, The Standard-Vacuum Oil Company and the United States East Asian Policy, 1933-1941 (Princeton: Princeton University, 1975), 25; and Furvinall, Netherlands India, 328.

[93] Detailed analyses of Standard's attempts to enter the East Indies petroleum market have been covered in a number of studies. See Reed, "Standard in Indonesia," and Williamson, American Petroleum Industry.

Shell Transport and Royal Dutch Petroleum Company Ltd. on 17 May 1902.[94] On 27 June 1902, Royal Dutch and Shell signed a market-sharing agreement with the Rothschilds to establish the Asiatic Petroleum Company which began operations in 1903. Royal Dutch negotiated a 60/40 merger with Shell in 1907 to the latter's disadvantage. The formation of the Asiatic Petroleum Company and the merger between the Royal Dutch and Shell were measures impelled by the need to "integrate vertically from production through marketing, Shell to assure low cost sources and Royal Dutch to survive price cutting."[95]

This situation was very different from what Zjilker and Kessler, the Royal Dutch's progenitors, had imagined - unbridled competition and the rule of capture after the American model, the product of the incessant and cut-throat price wars that characterised the international oil industry in the late 19th and early 20th century. In 1901, according to Kessler's dying wish, Deterding was elected managing director of Royal Dutch, a position he held for the next thirty five years. For his contributions to the Royal Dutch, oil historians have elevated Deterding to legendary proportions, Zjilker has more often than not been obscured, and Kessler receives a cursory salute. Deterding's biographer has described him as "Napoleanic in audacity and Cromwellian in thoroughness."[96]

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[94] Gerretson, Royal Dutch, vol.2, 238.

[95] William N. Greene, Strategies of the Major Oil Companies, Research for Business Decision Series, no.70 (Ann Arbor, Mich.: UMI Research Press, 1985), 213-218. By 1907 Samuel had lost control and 60% ownership to Royal Dutch. The latter was 1/10 of Shell's size in 1901. Ibid., 215.

[96] George Sweet Gibb and Evelyn H. Knowlton, The Resurgent Years: 1911-1927 (New York: Harper, 1956), 79.

For his role in the international oil industry, it has been said that Deterding did for the oil industry of the New world what Rockefeller did for the Old.[97] Rockefeller's philosophy had been to outbid or buy out his rivals, a rule that governed Standard policy until the Achnacarry Agreement.[98]

It is no historical accident that the 1928 "as is" or Achnacarry agreement was Sir Henri Deterding's brain-child. Deterding embraced the principle underlying the old Dutch proverb, "Eendracht maakt macht"(cooperation is power).[99] Based on Adam Smith's dictum that "if one pleases to do what the market disapproves, the price of individual freedom is economic ruination,"[100] Deterding had always rejected unbridled competition in favour of three principles: "free transport, free production and free price-fixing."[101]

Deterding's scheme involved cooperation at two levels: to bring all producers in one region into a voluntary association for the purpose of joint transportation and distribution in the Eastern market; to achieve a division of markets on a world scale to prevent price wars.[102] Whence sprang his famous battle cry which was to become the basis of the Achnacarry Agreement "uniform but fair prices, by mutual arrangement, all over the world."[103] But his attempt to achieve a cooperative arrangement with the Standard came to naught. "While Standard would not disagree with such a laudable motive it declined to enter into a cartel arrangement with upstarts and inferiors."[104] This was in 1910. Soon the Dutch colonial government would exploit the rivalry between Royal Dutch and Standard.

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[97] Kendall Beaton, Enterprise in Oil: A History of Shell in the United States (New York: Century Crofts, 1957), 34.

[98] The meetings held by Deterding, Walter Teagle of Standard and John Camden of British Petroleum began in the early months of 1928. They culminated in the Pool Associations or the Achnacarry Agreement which derives its epithet from Achnacarry Castle in Scotland where the three men had ostensibly gathered for a bout of grouse shooting. The main aim of the agreement was to limit cut-throat competition in the oil industry by controlling production and prices. A detailed description of this classic event in the oil industry's history is available in most studies pertaining to the international oil industry. For instance, see Anthony Sampson, The Seven Sisters: The Great Oil Companies and the World they Made (London: Hodder and Stroughton, 1975), 86-87. For a discussion of the price wars until 1928 and the Achnacarry agreement see Harvey O'Connor, World Crisis in Oil (New York: Monthly Review Press, 1962), 25-90.

[99] The phrase literally means "pulling together makes power." Beaton, Enterprise in Oil, 35; see also, Richard O'Connor, The Oil Barons: Men of Greed and Grandeur (Boston: Little Brown, 1971), 110.

[100] Heilbroner, The Worldly Philosophers, 5th ed., (New York: Simon and Schuster, 1980), 56.

[101] Gerretson, Royal Dutch, vol.2, 176.

While the Royal Dutch was consolidating its position in the East Indies and elsewhere, the imperial state discussed proposals and introduced legislation to increase its share of rents from new concessions, a right that the States-General unequivocally cemented. Several parliamentarians proposed schemes to achieve this objective. Pijnacker Hodijk hoped for thirty percent of net corporate profit. De Savornin Lohma and Pytterson believed that state ownership entitled it to one-third of a concessionaire's working capital. These were ambitious plans compared to the meagre royalties that the state had requested under the 1899 mining law.[105]

But Governor-General Van Heutsz, a staunch mercantilist who sought economic and political power for the Dutch state, had grandiose plans. He had successfully directed the forward policy and the subjugation of Acheh in 1904, the home of the rich Djambi fields. Immediately, he instigated an amendment to the 1899 mining law so that the state could establish joint exploration agreements with companies such as Royal Dutch.[106] Section 5(a) of the 1910 amendment gave the state the right to "either undertake development or prospecting on its behalf or to enter into agreements with persons or companies by which the latter would bind themselves to undertake development or prospecting and development" in free areas reserved for that purpose.[107]

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[102] The Eastern market included the territory circumscribed by an imaginary line running eastward from Alexandria to Japan, then southwards to include Australia and then westwards to the Cape and northwards to encompass Alexandria. Ibid., 247.

[103] Ibid., 182.

[104] O'Connor, World Crisis in Oil, 54.

[105] Gerretson, Royal Dutch, vol.2, 311.

In 1918, the Dutch government amended Article 5a of the 1899 mining law again. It claimed a 50% stake in all future concessions. It could legitimately expropriate commercially viable concession areas by merely reimbursing the prospector's actual expenses.[108] Petroleum and coal were defined as a strategic resources[109] controlled by the state.[110] While private entrepreneurs could freely prospect for petroleum, they required the government's assent to develop their discoveries.

The amendment gave the state a right to higher economic rent for all concessions: companies would pay a four percent royalty on realised prices or gross proceeds; and a 20% profit tax on production profits. For new concessions the state would also extract a 20% tax on corporate profits. All rents and taxes were based on realised prices. The state also imposed an area rental and taxes on the companies exporting and marketing activities.[111]

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[106] Ibid.

[107] Ibid; The provisions of Article 5(a) are to be found in the Amended Statute 588, 1910. For a complete translated version of the Statute see Robert Fabrikant, Oil Discovery, 1-30.

[108] Reed, "Standard Oil in Indonesia," 317.

[109] The basic stipulations of the amendment are to be found in Statute 1919, No.4. An unabridged version of the amendment is available in Fabrikant, Oil Discovery, 30-108.

[110] Vandenbosch, Dutch East Indies, 250; Gerretson, Royal Dutch, vol.2, 313.

A government can obtain more advantageous terms in its oil agreements if there is competition among the oil companies. Competition can take several forms; the state may exploit the resource itself or it may negotiate more favourable terms with other firms. Effective competition reduces the profits available to the firm.[112] In addition, companies can expect substantially reduced profits in a country where proven reserves exist as opposed to the return they might expect in high risk unexplored areas. The first concessionaire who is responsible for reducing this risk stands to lose from this very reality. "Once an investment has been made which proves to be a bonanza, the returns necessary to induce (or retain) capital investment into the concession area(or adjoining areas) drop sharply."[113]

After freezing concessions in 1904, Governor-General van Heutsz approached Royal Dutch to establish a joint development agreement. He agreed with the prevailing view in the Mines Department that a joint agreement with Royal Dutch was necessary for the government to achieve the technical expertise to implement Article 5a properly.[114] Deterding shunned a partnership with the government. He bluntly told van Heutsz that such an arrangement was unacceptable because the state would seek to direct the enterprise, renegotiate contractual terms and demand higher profits. He foresaw the possibility of being held hostage by a government which would gradually increase its bargaining power with respect to private enterprise.[115]

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[111] Khong Cho Oon, The Politics of Oil in Indonesia: Foreign Company-Host Country Relations (Cambridge: Cambridge University, 1986), 35.

[112] Edith Penrose, The Growth of Firms, Middle East Oil and Other Essays (London: Frank Cass, 1971), 158-9.

[113] Mikesell, "Investor-Host Country Relations," 35.

[114] Gerretson, Royal Dutch, vol.2, 311.

Companies seek to reduce government intervention in their activities. They seek to hold on to the advantages that they had obtained in their original concession agreement. The purely domestic company is more at the mercy of its own government than a firm with a transnational reach. The majority share in the Royal Dutch/Shell was Dutch. But it was no longer a domestic company in the strict sense.

It had become international with its merger with British Shell in 1907, a fact that worried the Netherlands government in these days of inter-imperialist rivalry. And its world-wide interests gave it a transnational flavour that reduced its dependence on the Dutch government's goodwill. Along with Standard it monopolised the world oil market.[116] Deterding had entered the American market, it had staked a claim in Mesopotamia, and by 1914 the Royal Dutch Mene Grande field in the Lake Maracaibo region was proved and became more lucrative than the company's concessions in the East Indies itself.[117]

But Djambi was a lucrative concession. The colonial government was unwilling to relinquish it without ensuring a sizeable share of the profits for itself. It had also discovered the strategic importance of petroleum. So it struck a harder, tougher bargain. The colonial state challenged the monopoly power of the company by introducing competition. Anti-trust legislation ordering the dissolution of the original Standard Oil Company in 1911 had left Standard Oil of New Jersey(Jersey) with extensive refining and marketing facilities but inadequate production sources for fully integrated operations.[118] This was a welcome opportunity for the Dutch state. It issued a concession to the Nederlandsche Koloniale Petroleum Maatschappij (N.K.P.M) on 12 April 1912, which later became the Standard-Vacuum Oil Company's producing branch.[119]

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[115] Gerretson, Royal Dutch, vol.4, 92-98.
[116] O'Connor, World Crisis in Oil, 45.
[117] Ibid., 59, 74.

Now in 1912, Deterding reacted immediately to the government's decision. The government's strategy had worked. Royal Dutch now offered to share profits equally with the government.[120] But now the government sought even better terms. It asked Royal Dutch to give it a voice in the company's management and a twenty-five year fuel supply contract.

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[118] Anderson, Standard-Vacuum Oil Company, 25. Jersey had access to only 7,500 bpd in domestic supplies compared to its daily requirement of 96,000 bpd. The East Indies was one of its obvious choices. Anderson, Ibid., 27; see also Mira Wilkins, Emergence of the Multinational Enterprise, 86. The original Standard Oil Trust of 1882 was converted into a loose holding company in 1892. The principal corporation, Standard Oil of New Jersey was given direct legal control of forty-one affiliated companies in 1899. It was this move which was declared illegal by the U.S. Supreme Court in 1911. The Supreme Court's decision forced Jersey to divest itself of its subsidiaries including Standard of New York, the Vacuum Oil Company and Standard of California. In 1931 Standard Oil of New York, which inherited Jersey's newly established Asian distribution network, merged with the Vacuum Oil Company to form Socony-Vacuum(later Mobil). When California Standard merged its overseas marketing operations with The Texas Company to form Caltex in 1936, it became Jersey's rival in the Orient. Anderson, Standard-Vacuum Oil Company, 26.

[119] Ibid., 28-29. The N.K.P.M. submitted 1,364 applications for prospecting licenses. Two licenses were granted, both of which proved worthless. In April 1913, a total of 215 prospecting licenses were approved. Eleven mining concessions were granted to Bataafsche Petroleum Maatschaapij(B.P.M), the principal Dutch-Shell subsidiary in Indonesia while none were granted to the N.K.P.M. Reed, "Standard in Indonesia," 316.

[120] Gerretson, vol.4, 92-8.

> During the era of liberalism the development of the oil industry had been merely an object of general, or at most fiscal interest to the government, as was the development of all other natural resources in the Archipelago. Now, however, the government, as a large consumer of a product indispensable for its own security, was confronted by a producer whom it held in its palm, owing to its control of the concession.[121]

The colonial state did not achieve its last two objectives. But, in 1921, van Heutsz's cherished dream was realised in a 50/50 joint agreement between Royal Dutch/Shell and the government. This was the colonial state's last bargain with the oil firms. Theoretically, the government received approximately 50% of the gross profit. Since the fledgling post-colonial state was unable to achieve even these terms until the mid-1950s, this issue will be discussed in greater detail in the next chapter. From 1918 to 1963, the 1918 amendments regulated the Dutch East Indian and the Indonesian oil industry, or not at all.

Two factors reduced the colonial government's bargaining power after 1921. First, the American government's intervention forced the Dutch state to allow American companies to enter the East Indies on equitable terms - terms already established for oil company operations. Second, the structure of the international oil industry after the 1928 Achnacarry agreement, that fabled oil agreement that brought Deterding's dream to fruition - the desire to end unlimited competition by fixing prices, production, and markets, ended competition among the oil majors. The demise of competition brought cooperation among the oil majors on matters relating to concession terms in the oil producing countries of the world. Now they, not the imperial powers, would dominate the world oil scene unchallenged for the next four decades.

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[121] Ibid., 97.

The United States government had responded to the Djambi episode with its brand of protectionism. Royal Dutch-Shell subsidiaries were denied leases on public lands in Utah, Wyoming, and Oklahoma. The Dutch government was told to create an impartial climate for American corporations if it wanted the American government to reverse its decision. Although the Dutch government did not annul its Djambi contract with Royal Dutch-Shell the American government's actions facilitated Jersey's formal entry, in its American guise, into the Netherlands East Indies in June 1925. The company received concessions in Java and Madura.[122]

Jersey's success in obtaining a concession did not eliminate protectionist tendencies in the Netherlands East Indies. Standard of California (Chevron) was refused a concession in North Sumatra. But the government could not prevent foreign companies from establishing Dutch subsidiaries. Consequently, after consultations with the State Department, Standard of California founded a Dutch subsidiary Nederlandsche Pacific Petroleum Maatschappij (NPPM) in 1930. It doggedly pursued the Rokkan Block concession in central Sumatra which it obtained in June 1936. In the same year it merged with the Texas Company(Texaco). The two companies pooled their interests in the Far East to create a vertically integrated company, Caltex - Texaco's marketing strength was merged with Standard's production capacity.

Jersey merged its NKPM holding to form a subsidiary with Standard of New York (Socony Vacuum, now Mobil) called the Standard Vacuum Petroleum, which in

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[122] Bartlett, Pertamina, 47-48.

1947 was changed to P.T Standard Vacuum Petroleum or Stanvac. By the mid-1930s along with Royal Dutch-Shell, five of the seven sisters were operating in the East Indies.

Until the Second World War, Royal Dutch-Shell dominated Dutch East Indian petroleum industry. The company's operations extended down from North Sumatra to New Guinea and included concessions in every known producing region with the exception of central Sumatra. Royal Dutch-Shell was the operator of both joint ventures with the government, holding a 50% interest in NIAM and a 40% interest in NNGPM. Although Stanvac's operations were limited to south and central Sumatra, its Talang Akar concession became the largest field discovered in the East Indies before the war. By the time World War II broke out in Asia, Stanvac's Sungei Gerong refinery was the largest in the Far East with a refining capacity of 45,000 bpd. Together, Royal Dutch/Shell and Stanvac dominated the colony's domestic marketing as well as production. Caltex struck oil in the Minas field in 1944, which after the war became one of the twenty-five largest fields in the world. Together, these three companies monopolized the Indonesian oil industry until the mid 1960s.

Conclusion

In defence of the national interest the Dutch imperial state transformed the nature of landownership on Java to enhance its control over land which it could then freely distribute to planters and miners alike. In the Outer islands, it first reified the fictitious idea of the native ruler as master of all he surveyed. When the proprietary rights of the native rulers began to interfere in the state's enjoyment and control of mineral resource revenues and its foreign policy interests, the interloper was converted from vassal into puppet.

The state's initial interest in promoting the development of mining enterprises stemmed from its desire to reduce its dependence upon foreign mineral resources. But this objective was subordinate to the promotion of the cultivation system on Java and to preventing foreign dominance in the Archipelago. It was to fulfill the latter objective that private enterprise was allowed to operate in relative freedom from government intervention, establish autonomous contracts with the native rulers and in short make the Dutch presence visible in the Outer Islands. In this way, the state had no need to expend the military and financial resources to provide private enterprise with security in the laissez-faire war of all against all. In the mid-nineteenth century the miner was a poor cousin to the tobacco planter, whom the state could ill-afford to protect.

By the late 19th century however, the state's objectives changed. The viability of petroleum production had been established. Potential revenues from the lucrative industry, particularly from its more successful components, became a temptation too difficult to resist. The state arrogated all mining rights and became more restrictive in granting concessions, safeguarding the interests of a chosen few against the interests of all. Economic nationalism served to equate the general good with the interests of a private enterprise which was unable to compete effectively with its foreign competitors. Simultaneously, the state's self-interest lay in transforming itself from mere rentier to participant entrepreneur through cooperative arrangements with private enterprise.

In this attempt it failed. Although, as the Djambi case illustrates, the state was in a strong bargaining position vis-a-vis the integrated oil company before it granted a concession and was therefore able to achieve an enhanced share of revenues under the 5a contracts, the state lost effective control over the concession after it had been granted. Thereafter, there was no hindrance between "man and mine." It is this question which will be the subject of discussion in the later chapters on the post-colonial state's relationship with the transnational oil companies.

Chapter 3

Oil in the Era of Aggressive Nationalism

When Indonesia gained independence in 1949, the nature of the state underwent a fundamental change. So did the idea of what constituted the national interest. In this sense, the Round Table Conference heralding Indonesian independence constituted a watershed. Before 1949, the colonial state acted primarily in the interests of the Dutch nation. After 1949, however, the state was supposed to advance the interests of what goes by the name of the Indonesian nation, even though in practice it may only mean the Indonesian elite. It was also supposed to meet the aspirations of Indonesian nationalism.

The term Indonesia originated in an unlikely quarter. In its Indology course the University of Leiden used Indonesia to describe the Southeast Asian archipelago. Javanese students sought to justify an Indonesian nation-state because the territorial reach of the legendary Madjapahit empire almost coincided with that of the East Indies. Afraid of Javanese domination, non-Javanese students preferred to view Indonesia as a twentieth century phenomenon.[1]

When Gellner argues that "nationalism is not the awakening of self-consciousness; it invents nations where they do not exist,"[2] Anderson admonishes him for attributing

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[1] Mavis Rose, Indonesia Free: A Political Biography of Mohammad Hatta (Ithaca:Cornell University Press, 1987), 18.

[2] Ernst Gellner, Thought and Change (London: Weidenfeld and Nicholson, 1964), 169 cited in Benedict O. Anderson, Imagined Communities: Reflections on the Origin and Spread of Nationalism (London:Verso, 1991), 6.

"falsity" and "fabrication" to a phenomenon actually created through imagination.[3] Anderson argues that all communities requiring larger than face-to-face contact are imagined.[4]

Specifically in the context of Indonesia and other Asian and African countries, it has been argued that Western dominance and imperialism brought certain territories together which were never united before. Indonesia's present geographical sweep was due to the accident of this whole area being brought under Dutch administration. And had this accident not occurred, there would probably never have been an Indonesian nation or Indonesian nationalism.

But this argument is no more valid than the chance that Queen Elizabeth I died without leaving a direct heir and that the accession of James I to the English throne slowly created the conditions for the Union of England and Scotland. Similarly it was the accident of Lincoln's victory and the extermination of the American Indians in their homelands that led to the creation of the U.S. nation and nationalism.

Indonesia was imagined in one specific sense. It had not been a unified community before colonial rule. When nationalist leaders decried three hundred and fifty years of subservience and sought historical justifications for an Indonesian nation-state, they were whetting their imagination. If they had contended that parts of Indonesia had been subject to foreign domination for three hundred and fifty years and that gradually the whole archipelago had become a colonial appendage, they would have been correct.

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[3] Ibid.

[4] Ibid.

But the Netherlands East Indies as one territorial and administrative unit did become a reality under colonial rule. It developed historically through treaties, conquest, war and plunder. The idea of Indonesia as a nation grew from an anti-colonial and anti-imperial stance. This idea became closely tied to capitalism because imperialism had enabled foreign capital to control the natural resources of the archipelago and its land for commercial production.

Nationalism tends to unify members of a community across class lines by appealing to shared passions warranting united action against an enemy whose interests are juxtaposed against those appetites. In the Indonesian archipelago the majority of coloured peoples unequally shared the socio-economic and political disadvantages that flowed from their pigment. This shared state did not have to be imagined. It had to be articulated and set in motion. What had to be articulated was the notion that these common disadvantages were binding enough to justify a common struggle. Western education produced well-trained native civil servants and the tools to articulate national consciousness. Avid readers of Western philosophy and history, potential nationalist leaders learnt that in nineteenth century Western Europe the nation had come to legitimately replace the sovereign monarch.

The Sumatrans, Bataks, Sundanese and Javanese communities were in unison, if only because they were subject to the laws of the colonial state. Foreign control over the means of production and the wealth generated from the natural resources produced in the archipelago provided another basis for unity as have nots. A common bond had developed historically where there was none before. This bond was not a figment of imagination. Nor was the patronising white visage imagined. Like class differences, it was experienced. Colonialism had created a common identity just as three hundred-odd years before, the patriots and liberators in the Netherlands had rallied around the cry for religious freedom to demand and achieve their independence from a bigoted Spanish Crown.

While they were fighting for independence, Indonesian national leaders felt impelled to right the wrongs against themselves, the peasants and workers and to safeguard the interests of the people. They had carried on agitations against Dutch political domination and the exploitation by Dutch and other transnationals of Indonesia's resources. When, therefore, they achieved independence and political power, they were faced with the problem of how they could secure Indonesian interests in the context of host state/transnational relations.

In doing so, they had to contend with at least four factors. First, there were the limitations of the Round Table Agreements by which Indonesia had achieved independence. This agreement bound independent Indonesia, as a successor government, to respect the various agreements of the erstwhile colonial state with the transnationals. The agreements had given more favourable terms to the transnationals than even the pre-war agreements. Second, Indonesia could not do anything unilaterally or adopt a confrontational approach which might threaten the flow of oil. Here the international structure of the oil industry also had a significant impact.

Third, Indonesia had also to reckon with the fact that the international system for many years was more favourable to the transnationals than to the Indonesian state. The international system may have been bipolar in a European or global sense, but in the late 1940s and early and mid-1950s, the United States had preponderant power in Southeast Asia and it was not averse to using its power in the interests of its corporate citizens. Fourth, Indonesian decision-makers also had to recognise the expectations generated by Indonesian nationalism and the national movement.

These four factors were not easy to reconcile. The first three factors obviously favoured the transnationals: any attempt at using strong-arm tactics with the transnationals could stop the flow of oil, bring a near halt to essential foreign exchange earnings and could conceivably pose the danger of foreign intervention.

Section I

What were the expectations of Indonesia's nationalist opinion in the context of the transnationals? A generic answer is not possible: as in nationalist movements elsewhere in the world, and more particularly in colonial societies, there were several currents and cross currents in the nationalist discourse. However, two major opposing themes for a future state and society developed in the Indonesian nationalist movement. One sought to reify tradition, the other to confront it, and if necessary to uproot it. These, of course, were the two extreme ends of a continuum in the midst of which syntheses, syncretism, and eclecticism flourished. In varying degrees, the conservative-collectivists and Islamic groups looked back to Indonesian and/or Islamic tradition for inspiration and to adat principles for sustenance. From 1953 into the Suharto period, the army would also draw upon the conservative-collectivist vision to justify greater state intervention in the political and economic life of the nation. The conservative- collectivists favoured the first tradition; the social democrats and the marxists fancied the second. These visions of a future state and society were hotly debated in the colonial period and provided the foundations for political activity in the revolutionary and post-colonial period.

The conservative-collectivists believed in a strong paternalistic, benevolent state.[5] The ideologue of this traditionalist vision of a future society was Dewantaro to whom Sukarno acknowledged his indebtedness.[6] In the main support for this group of traditionalists came from among the gentry, middle class, bureaucrats and professionals. The Islamic group of traditionalists sought to establish Dar-ul-Islam, the ideal Muslim state.[7] The opponents of these perspectives were the modernists, educated in the Western tradition. They followed one of two models. The one renounced their heritage and embraced Western culture in their private lives. What they believed and practised was of little consequence since they caused but a ripple in social and political life.

The second group of modernists, who eventually came to represent the mainstream Islamic perspective in the revolutionary and post-revolutionary period, combined their faith in Western science with specific tenets of the Koran and Hadith which served as beacons, not imperatives.[8] The followers of this view assembled in the

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[5] Sukarno, "Marhaen and Proletarian," Speech before the Indonesian Nationalist Party at the Party's Thirtieth Anniversary at Bandung, 3 July 1957, 12-13.

[6] For an excellent discussion of the conservative-collectivist vision and Dewantoro's role in promoting it see David Reeve, Golkar of Indonesia: An Alternative to the Party System, (Singapore: Oxford University Press, 1985), chap.1.

[7] K.E. Ward, The Foundations of the Partai Muslimin Indonesia, Modern Indonesia Project, Southeast Asia Program, Interim Report Series (Ithaca, N.Y.:Cornell University Press, 1970), 7.

[8] George McTurnan Kahin, Nationalism and Revolution in Indonesia (Ithaca, N.Y: Cornell University Press, 1952), 88; Ward, "Partai Muslimin," 5.

Sarekat Dagang Islam (Islamic Trading Centre), originally founded to combat Chinese trading practices and consisting mainly of merchants, educated youths, religious leaders, peasants and workers. It was the party of the petty bourgeoisie, particularly threatened by entrenched Chinese trading interests. The party aimed to achieve self-government, promote commerce among Indonesians, support economically destitute members, promote Indonesian intellectual advancement, material interests, and religious life while correcting misconceptions about Mohammedanism. In 1914 growing pressure from its Marxist-oriented regional branches forced the central leadership to condemn "sinful capitalism", a point which distressed the party's merchants so much that Tjokroaminoto, the Masjumi stalwart, was forced to modify the statement. Now foreign capitalism became sinful. By inference, Indonesian capitalism was acceptable.[9]

In the revolutionary and post-revolutionary period the Islamic visionaries gathered in the Masjumi and two of its right-wing offshoots the PSII and the NU. In its fighting program published on 20 December 1945 Masjumi declared, "Islam opposes the cruelty, ferocity, and falseness of capitalism and imperialism." Unbridled capitalism linked with imperialism was harmful. The immediate goal was to overthrow the imperial enemy, upon which it would wholeheartedly support chaste domestic capitalists. Drawing from fundamental Islamic precepts the party called for a combination of private property rights, which it ardently defended, with a welfare "people's economy" based on the principle of mutual self-help.[10]

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[9] Kahin, Nationalism and Revolution, 73.
[10] Ibid., chap.2.

The social democratic conception, of which the thinking of Sjahrir was the most representative, sought an industrialized economy, an egalitarian society, and an activist welfare state founded on democratic principles. Sjahrir was deeply committed to individual freedom, that precious commodity to which he clung throughout his life. He rejected tradition, which in his view was responsible for the stagnation of the East. He sought fundamental changes in some Eastern attitudes:

> For me the West signifies forceful, dynamic, and active life. It is a sort of Faust that I admire, and I am convinced that only by the utilisation of this dynamism of the West can the East be released from its slavery and subjugation. ...even a Faust, striving and struggle have implications of constructive work, of undertaking great projects for the benefit of humanity. ...I would even accept capitalism as an improvement upon the much famed wisdom and religion of the East. For it is precisely this wisdom and religion that make us unable to understand the fact that we have sunk to the lowest depths to which man can descend: we have sunk to slavery and to enduring subjugation.[11]

Although he believed in socialism, for Sjahrir capitalism represented a higher civilisation than the stagnation of the East. But not all social democrats rejected tradition. Hatta derived his belief in village democracy and economic cooperatives from tradition. He was devoted to social democracy and he conceded the merits of capitalism - its promise to provide industry, mass production, better living standards, and mass education.

Like western social democrats, Indonesian social democrats argued that enhancing production and welfare were not ends in themselves but the means to maximise gains for the "collectivity" through a planned economy based on the socialist ideal of distributive justice and the elimination of free market forces.[12] These objectives would require the support of the industrialized West with its superior technological prowess and financial capability.[13] Social democrats believed in a strong cadre party.

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[11] Sutan Sjahrir, Out of Exile, Translated with an introduction by Charles Wolf. (New York: Greenwood Press, 1969, translation of Indonesische overpeinzingen, New York: J. Day, 1949, letter dated 31 December 1936, 144-145.

The major difference between conservative-collectivists and the social democrats was that the former wanted a complete break with tradition whereas the latter emphasized the need to integrate and maintain some aspects of traditional culture. Both rejected the selfish materialism of the West. Both rejected visions of an Islamic state and the dictatorship of the proletariat. It was in the causes for their rejection of the Islamic and Communist models that the two models differed. The conservative-collectivist rejection stemmed from its belief that Indonesia was an amalgamation of groups. As such the new state should represent the interests of all groups not just class and religious interests. Like Mao Tse-tung, Sjahrir believed that the Indonesian revolution had two tasks: the national and democratic revolutions. To shelve the democratic revolution until independence, this he would not brook. For him, the establishment of a democratic system was necessary as a matter of principle and for pragmatic reasons.

In addition to these two groups, there were, of course, the marxists, or rather, the Communists. Their programs did not include a blueprint for a future society, perhaps because these were seen as axioms. They did not seek a social revolution. The question of combining the social and national revolutions only became controversial for a brief period in 1948. In the post-revolutionary period the PKI continued to stress the two-stage revolution: the national revolution must precede the social revolution. The social revolution was a distant objective.

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[12] "Our Nationalism and its Substance: Freedom, Social Justice and Human Dignity," in The Voice of Free Indonesia, I, (April 27, May 4, and May 18, 1946) cited in Jeanee S. Mintz, "Marxism in Southeast Asia," A Study of Four Countries ed. Frank N. Trager (Stanford: Stanford University Press, 1959).

[13] R.W.Liddle, "Modernising Indonesian Politics," Political Participation in Modern Indonesia, monograph series no. 19, ed. R.W.Liddle (New Haven, Conn.: Yale University Southeast Asia Studies, 1973), 180.

It was in the 1920s and in 1948, the two periods when the PKI had accumulated significant power and followers, that the divisions among the leftist forces became intense. In the 1920s, the purists who came to control the party rejected an alliance with the religious nationalists, abandoned peasant in favour of trade union mobilisation, and supported immediate revolutionary action against the better judgment of Stalin, the Comintern leadership, and Tan Malaka, the Indonesian marxist leader in exile and Comintern Southeast Asia representative. In 1926 the purists rose anyhow. The colonial government destroyed their party. Many of them were exiled or arrested. And the purists blamed Tan Malaka for their failure.

On 11 August 1948, one of these purists, Musso returned to Indonesia secretly,[14] this time with Moscow's blessings and organised the Madiun rebellion against the Sukarno/Hatta government. Both times, the communists suffered major defeats and heavy losses. It was only after the post-independence period that the party made a spectacular entrance onto the political scene. In 1954 the party produced the blueprint which would provide the philosophical basis for much of its political programme until its demise in 1965.

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[14] His return did not remain a secret for very long. On 13 August he met Sukarno. They had become acquainted when they had lived with the Sarekat Islam leader Tjokroaminoto during their student days. For a good discussion of the PKI's role during this period see J. Mintz, The Road to Madiun: The Indonesia Communist Uprising of 1948 (Ithaca: Cornell University Press, 1989).

These four world views did converge on one issue, a fundamental role for the state in the economy. Where they differed was on the timing and extent of this intervention. Article 33 of the 1945 constitution became engraved in stone:

> 1. (The) economy shall be organised cooperatively.
> 2. Branches of production which are of importance to the state and which affect the life of most people, shall be controlled by the state.
> 3. Land and water and the natural riches therein shall be controlled by the state and shall be exploited for the greatest welfare of the people.[15]

Section II

All the major political currents in the nationalist discourse held firmly to the belief that the state should control the natural wealth of the nation. This was a common world-view among nationalist leaders in the industrialising world. The legendary leader Sun Yat-Sen and the Indian leader Jawaharlal Nehru had expressed identical views. The interpretation and application of Article 33 of the 1945 Constitution became a fundamental question of debate and acrimony since its very conception. But no one dared or sought to tamper with it.

There was no consensus in the national movement on the role of foreign capital. There was a difference of perspective on this issue between the moderates such as Sukarno, Hatta and Sjahrir on the one hand and between the "warriors" consisting of fundamentalist muslims, many conservative-collectivists and even some ultra-leftists on the other. In the Guided Democracy period, the conservative-collectivist cause with respect to the oil industry would be taken up most vigorously by army officers. These differences became apparent during the four years of the Republican government between 1945 until Indonesian independence in 1949. When in 1945, Indonesians declared independence, several militias and workers supported by the "warriors" seized foreign property. Sukarno, Hatta and Sjahrir denounced these actions as anarcho-syndicalist acts. It was not conservatism that drove them to curb the so-called anarcho-syndicalist tide. On the contrary, they believed that education, technical skills and capital were essential to achieve industrialisation.

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[15] John O. Sutter, Indonesianisasi: Politics in a Changing Economy: 1940-1955, vol. 1 (Ithaca: Cornell University Press, 1959), 275.

As Penrose argues, industrialising country leaders do not care about the worldwide allocative efficiencies that liberal economists, those defenders of the transnationals, say they engender. Industrialising country leaders must be assured that transnationals will hasten industrialisation and bring tangible benefits to the host country.[16] It was their social democratic belief in the merits of the Western connection that drove Hatta and Sjahrir to assure the foreign companies that they would not nationalise the specialised oil industry.

As if God had ordained property rights, in an October 17 decree, Ir. Soerachman, Minister of Prosperity, charged with economic affairs, repeated an October 4 pronouncement, that the government's belief in justice and humanity compelled it to secure alien properties from the clutches of the anarcho-syndicalists by supervising them temporarily.[17] Hatta's brain-child, the 1 November 1945 Political Manifesto, which came to be regarded as the economic blueprint for the pre-August 1949 period, had an identical ambience.

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[16] Edith T. Penrose, The Growth of Firms, Middle East Oil and Other Essays (London: Frank Cass, 1971), 125.

It is one thing to reassure foreign investors while simultaneously placating nationalist opinion. It is quite a different matter not to bargain at all, to cede the country's sovereignty completely to the foreign influence as the Indonesian leadership appeared to have done when it negotiated the Round Table Conference Agreement with the Dutch government in 1949. The Republic of the United States of Indonesia(RUSI) agreed to assume the Netherlands East Indies government's debt, much of which had been accumulated during the four revolutionary years.[18] And the Indonesian delegation promised to secure almost all the rights, concessions and licenses that the colonial government had granted to foreign private property owners. The colonial government's 5a oil contracts were re-affirmed by the new Indonesian government. Expropriated property would be indemnified at its true value.[19]

Indeed, the Indonesian government had been forced to go a step backwards with respect to the oil companies. Either deliberately or because of its own weakness, the Dutch colonial government had reduced its bargaining power with respect to the oil companies. The Deviezen Instituut, the Dutch administration's foreign exchange regulation agency, had diluted the terms of the 5a contracts in the form of the "let alone" agreements, a point to which I will return shortly.

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[17] John O. Sutter, Indonesianisasi: Politics in a Changing Economy: 1940-1955 vol. 3 (Ithaca: Cornell University Press, 1959), 820.

[18] The total debt amounted to 4,300 million Dutch guilders. 1,291 million guilders was external debt and to be paid in foreign currency.

[19] Herbert Feith, The Decline of Constitutional Democracy in Indonesia (Ithaca, N.Y.,: Cornell University Press, 1962), 15. Of course, establishing true value is always tricky in the economic and philosophical sense.

Natural resource companies assess the profitability of a venture within the broad framework of three kinds of risks and uncertainties: technical or geological, economic and political.[20] Technical risks inhere in 'dry holes'. "...only by the drill bit can the presence, size and economic value of oil deposits be ascertained."[21] Oil may be found in grand quantities or not at all. In determining profitability, corporations must make allowances for dry holes when they initiate their investments.[22]

Economic risks lie in the profitability of a firm's operations, essential to its existence. Oil companies seek to reduce their economic risks by diversifying investments so that the losses incurred from dry holes may be offset by ample discoveries.[23] Political risks reside in war, civil disturbances, economic crises, and the potential termination of the oil companies' concessions, the imposition of heavier royalties or taxes, or even the nationalisation of all or part of its investment.[24] As Moran argues:

> For a preliminary approach to understanding the fundamental trends or cycles in bargaining relations between foreign investors and host governments one must add considerations about the role of uncertainty. There is always a great deal of uncertainty about whether the investment can be made a success and what the final costs of production and operation will be. ...The conditions under which a foreign company will agree to invest must initially reflect both its monopoly control of skills and

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[20] Neil H. Jacoby, Multinational Oil: A Study in Industrial Dynamics (New York: Macmillan, 1974), 16-19.

[21] Ibid., 16.

[22] For a good discussion see also Jack E. Hartshorn, Oil Companies and Governments, (London: Faber & Faber, 1967), chap. 4.

[23] Jacoby, Multinational Oil, 17.

[24] Ibid., 17.

its heavy discounting for risk and uncertainty.[25]

As specialists in the bargaining school argue, it is geological risk that is greatest when transnationals initiate a concession agreement. Natural resource transnationals usually play the "geological risk" trump card when they first enter the host country. In Indonesia, this variety of risk and uncertainty had been dispelled during the colonial era.

But a transnational's bargaining power with respect to the host government also increases when it promises to make a new commitment and when its assessment of political risk is high. At times, the power that its home government enjoys in international politics gives the transnational added leverage. The Indonesian war of independence gave the oil companies the bargaining advantage and the "political risk" trump card that they needed to press the Dutch government for better terms. To enter the war zone, to resume their operations, and to rehabilitate their damaged facilities they asked for better terms.

Stanvac and Royal Dutch/Shell secured their "let alone" licenses in 1948; Caltex in 1949. The Indonesian government inherited the "let-alone" agreements as part of the Round Table Agreement package which obliged the government to respect foreign property rights unless they defied the public interest. "Under the "let-alone" arrangements the company did not have to pay import-export duties, sales taxes and dividend taxes. The effective split was 60/40 in favour of the companies."[26] In addition, the Dutch government granted new concession areas to the three companies under the same blanket provisions. Two weeks before the final negotiations for the transfer of sovereignty, ostensibly to gain U.S. support for its negotiating position, the Dutch government granted Caltex a 381,080 hectare concession.[27]

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[25] Theodore H.Moran, Multinationals and the Politics of Dependence: Copper in Chile (Princeton: Princeton University Press, 1974), 158-9.

[26] Senior Vice-President Finance, major oil company, interview by author, Jakarta, 23 February 1987; Former accountant, major oil company, interview by author, Jakarta, 26 February 1987. Also see Jean Bush Aden, "Oil and Politics in Indonesia, 1945 to

The "let alone" permits were based on two assumptions: host governments should not enjoy a share of oil company revenues until the latter had recovered their investments; transnational corporations expected their subsidiaries to be profitable in their own right, recouping their investments as autonomous bodies. These conditions gave the oil companies added leverage with respect to their host. The result - the free foreign exchange facility became a tax exemption. As one oil company executive describes it:

> When Stanvac returned to Indonesia after World War II, [it had] to spend a lot of funds to rehabilitate its producing and refining facilities. Stanvac made an agreement with the Dutch government to spend US$60 million to rehabilitate and modernize the Sungei Gerong refinery. ...As a trade-off, the government agreed to grant Stanvac a relief in taxation which took the form of free depreciation.(Stanvac was free to choose when and how much to book depreciation expenses.) As a result, Stanvac did not pay corporation taxes until the early fifties. In addition, Stanvac was also exempted from payments of major taxes such as import and export duties, 4% gross production tax and the government share under the concession contract.[28]

1980," (Ph.D. diss., Cornell University, 1988), 103.

[27] Chairman, major oil company, interview by author, Jakarta, 7 February 1987.

[28] Senior Vice-President Finance, major oil company, letter to author, received 25 May 1989. Aden provides a different version. She notes that the colonial government reduced the corporate tax from 20 percent to 8 percent. Aden also assumes that increased production and exports alleviated the Dutch government's revenue problems but in the absence of tax payments to the government it is unclear how this could have been achieved. See Aden, Oil and Politics, 89-90.

Crude petroleum and product prices "were determined by the industry based on the market. The role of the Ministry of Economics was merely to confirm or formalize those prices...Until the late sixties the government continued the (pricing) practices (instituted) under the let-alone agreement."[29]

A public relations monograph published for Stanvac by the Centre of International Studies of the Massachussets Institute of Technology hastens to deny the tax-free basis of the "let alone" permits:

> The term "let alone" is inaccurate and misleading, and its use has caused many Indonesians to believe that the oil companies were getting some form of preferential treatment to the government's disadvantage - such as the freedom from tax liability. This is far from the fact.[30]

On the surface, the "let alone" permits merely "permitted the oil companies to apply their net foreign exchange earnings directly to the reconstruction and development of their Indonesian facilities and allowed them to recoup their investments in foreign exchange."[31] The oil companies paid high taxes, made heavy investments and paid for their imported raw materials and equipment from their own reserves.[32] The free foreign exchange facility merely enabled the foreign oil companies to recover their investments, and repay their loans to their parent companies, their affiliates or banks. But as we will presently see, the oil companies did not in fact pay the government any taxes in the early years.

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[29] Senior Vice-President Finance, major oil company, letter to author, received 31 May 1989.

[30] Stanvac in Indonesia (Cambridge, Mass.: M.I.T. Centre for International Studies, 1957), 43.

[31] Ibid.

[32] Ibid.

Section III

In the late 1940s and the 1950s, host governments were generally in a weak bargaining position with respect to the oil majors. This was because the oligopolistic structure of the oil international oil industry imposed serious constraints on the ability of host governments to challenge their power. A brief survey of the international structure of the oil industry will demonstrate the kinds of challenges that oil exporting countries had to overcome before they could even consider the idea of obtaining a larger share of rent or running their own industries.

Ranked in order of their crude oil production, the oil industry outside the United States was dominated by seven of the fully integrated majors - Standard Oil of New Jersey, Royal Dutch/Shell, British Petroleum Company, Gulf Oil Corporation, the Texas Company and Mobil Oil Company. Vertical and horizontal integration were characteristics of the industry; whether these were inevitable and necessary features of the industry are debated questions beyond the scope of this study. But from Achnacarry to the end of the 1950s, these features served to prohibit most independent firms and host governments from developing and marketing oil resources on their own.

Throughout the industrialising world, although large sections of the populace were ignorant of the oil industry's workings, they believed that the oil companies were prominent archetypes of imperialism.[33] The accusations, unpopularity, notoriety and suspicion against the oil majors stemmed from a variety of sources. "They have been too large, too obviously foreign, too closely tied to imperial powers, too heavily involved in an emotive extractive industry and too secretive about their operations."[34] They were seen as exploitative organisms that enabled foreign interests to use their political and economic power to prevent the host country from using its natural resources. Foreigners were seen to be taking decisions about and deriving the benefits from the natural resources that should rightfully benefit the host country's population.

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[33] Edith T. Penrose, The Large International Firm in Developing Countries: The International Petroleum Industry (London: Allen & Unwin, 1968), 250; For a brief appraisal of nationalist perspectives in the Arab world see David Hirst, Oil and Public Opinion in the Middle East (London: Faber & Faber, 1966).

The oil majors were gargantuan organisms with the capacity to exercise economic power in various forms, alone and in concert. They influenced prices and regulated output. They had the power to damage the host country's economy by halting production. "That they have this power gives them a strong bargaining position with respect to the government; the fact that they can use it only in extremis because of the enormous damage to themselves its use can bring, alleviates only a little of the prevailing resentment."[35]

These giants themselves fostered the mystical qualities surrounding their activities. When asked to explain the rationale for their pricing arrangements, the oil companies would argue that oil prices were driven by market forces and that anyway, because the industry was too complex, their opponents and outsiders could not possibly understand the pricing structure. So why bother explaining? Thus they closed the subject. Since the oil companies divulged little information and since only 20-30 percent of the crude produced outside the U.S. was sold arm's-length, it was even harder for outsiders, host governments included, to estimate the price structure of oil.[36] Most crude moved through the integrated channels, from producing to refining affiliate, invoiced at transfer prices derived from the international posted price for crude plus estimated long-term averages for freights.[37]

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[34] Louis Turner, Oil Companies in the International System, 3d ed. (London: George Allen & Unwin, 1983), 88.

[35] Penrose, The Large International Firm, 250.

The host country's bargaining power is limited when it cannot overcome barriers to entry - the advantages that the transnationals enjoy in operating the industry and marketing products.

> In general, the relative difficulty of entry into any industry is determined by the amount of capital required for an efficient scale of operations, the relative ease with which the necessary raw materials, plant, and equipment can be obtained, the scarcity and costs of technical and managerial personnel, the level of technological and political risks to be borne, and the time and costs of making effective contacts with buyers in product markets.[38]

In the 1950s, in varying degrees, the oil transnationals enjoyed a stronger bargaining position with respect to all oil producing countries. Their bargaining strength inhered in a number of factors. Their ability to raise funds surpassed the host governments' capabilities to secure capital. Even if host governments had managed to raise capital, access to the technology and technicians controlled by the majors, was an almost insurmountable feat. Host governments had a sparse entourage of educated individuals with knowledge of specialised petroleum technologies to occupy higher level management and planning positions. The most prohibitive barrier to entry for the host state was the majors' control over markets.[39] They owned most of the world's refineries or were linked to them by long-term supply arrangements.[40]

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[36] Hartshorn, Oil Companies, 133.

[37] Ibid., 134.

[38] For a discussion of barriers to entry see Jacoby, Multinational Oil, 122-123.

This barrier to entry was used most effectively in the archetypal illustration of the embargo against Iranian exports after the nationalisation of Anglo-Iranian in 1951. Throughout the 1950s, the demonstration effect of this case continued to haunt host governments, including the Indonesian government. It also added significantly to the majors' bargaining leverage with respect to their hosts. Iranian economic nationalists could make no claims to the majors' marketing and refining activities. They may have been able to produce oil but without customers this would be a poor accomplishment.[41]

Host governments had meagre knowledge of the intricacies of the industry, they were not seasoned in the art of bargaining with transnationals, and they were overwhelmed by the majors' power. Even in the early 1960s, the Shah of Iran, a legendary OPEC stalwart, commented: "I must admit we were just walking in the mist; not in the dark, but it was a little misty. There were still that complex of big powers, and the mystical power and all that magic behind the name of all these big [companies]."[42]

When it began bargaining with the oil companies in the early 1950s, the Indonesian government suffered from all these weaknesses. It had no mining law or mines department. The Indonesian Ministry of Economics Affairs and its foreign exchange agency L.A.A.P.L.N. were never privy to the companies' marketing strategies.

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[39] Turner, Oil Companies, 92.

[40] Ibid., 93.

[41] Ibid.

[42] Anthony Sampson, The Seven Sisters: The Great Oil Companies and the World They Made (London:Hodder & Stroughton, 1975), 60.

They lacked the staff and expertise to perform the task they had undertaken. They depended on the companies for facts, an unpalatable and weak position from which to begin bargaining.[43]

In the first three encounters, it became clear that transnationals could hold the Indonesian government hostage with their control over the purse strings and their threat to reduce investment commitments. There was little that the Indonesian government could do in the face of these strengths. But host governments, even very weak ones, are not necessarily passive. Even in their extreme weakness they can begin to dent the transnationals' oligopoly power, if only that.

The negotiations between Stanvac and the Indonesian government in the period leading up to the expiry of Stanvac's "let alone" agreement at the end of December 1951 and the re-negotiation of an amended version of the "let alone" permits in the 1954-1956 period are analysed within this background. The negotiations established a number of precedents for oil company/host government bargaining relations in Indonesia for the 1950s. They also established the U.S. State Department's willingness to provide diplomatic support to its corporate citizens. The oil companies underscored their position - they would not accept unilateral changes in their operational terms. They were prepared to provide the cash-strapped government with temporary relief through loans, and, on occasion, a larger share of oil income. But they would not share control over major pricing and marketing decisions. Since there were no arm's-length transactions, the

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[43] For a similar discussion about the Venezuelan Coordinating Commission's difficulties in monitoring the majors' activities in the late 1950s see Franklin Tugwell, The Politics of Oil in Venezuela (Stanford: Stanford University Press, 1975), 56, 59.

Indonesian government had to "trust" the oil companies for an honest transaction. The government might demand 65 percent of gross profits, but the companies would only concede 50 percent based on realised prices.

Although an agreement such as the RTCA was a blow to Indonesian nationalist hopes and almost humiliating for Indonesian nationalism, this was, as Feith argues, "the maximum political gain achievable in the current power situation."[44] Neither the Dutch, nor the transnationals, nor above all, the United States was willing to bail out the not too strong Indonesian leadership from this difficult dilemma. It is of course, true that the leadership itself was unhappy about the nature of the agreement, was divided on the issue of its acceptance, and had probably accepted it with the mental reservation that "it was not a sacrosanct document."[45]

Irrespective of their political complexions host governments seek to chip away at the resource rents of transnational corporations. The broken dreams and the fantastic development potential represented in the huge capital outflows which line the coffers of foreign companies and their shareholders, increases the sense of injustice in the host country and the desire to halt its victimization. These emotions and the objective reality of the host country's poverty, indebtedness, inability to industrialize and the revenue-earning potential of large natural resource industries gives the latter their strategic content and political visibility.[46]

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[44] Feith, Nationalism, 71.

[45] Ibid.

[46] This forms the core of the obsolescing bargain model which several scholars confirmed after Theodore Moran, inspired by Raymond Vernon, first initiated it. See Moran, Politics of Dependence, chap.6. Also see Raymond Vernon, Sovereignty at Bay:

There is an inevitable desire to change the existing terms, especially when the terms are seen as a vestige of colonialism. The "let alone" agreements were vestiges of colonialism, thrust upon an unwilling but powerless government by a weary but insistent outgoing colonial power. Independence demanded that the Indonesian government negotiate its own terms and conditions with the oil companies, even if the latter continued to occupy centre stage in the new state.

Throughout the 1950s the need to control the oil companies' activities was a pedestrian refrain, heard in high places and modest coffee-shops. Indonesians were economic nationalists. The "let alone" licenses were not criticised by the left alone. All sections of the political elite and the intelligentsia joined the chorus. M.P Hoetomo Soepardan, the PKI's economic affairs critic, charged that the "let alone" agreements had caused the government a net Rp 1,616, 067,000 loss to the government. Ali Wardhana, an economist at the prestigious University of Indonesia, a champion of orthodox liberal principles, who later became the chief architect of the New Order's economic stabilization program in 1966 for which his Western educated team earned the disparaging epithet "Berkeley Mafia," wrote in 1957, "Though petroleum and petroleum products still play an important part in the exports of Indonesia (i.e. 9.1% and 24.5% in 1953 of the whole value of exports), yet because of existing special contracts with the oil companies, the government has been altogether powerless in the face of proceeds of oil sales abroad."[47]

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[47] Ali Wardhana, "Foreign Exchange and Its Implications for Indonesia," Economi dan Keuangan 10, no.10 (1957), 701-702.

Except for the difference in tone, the analysis of the editor of the Communist Party's People's Daily converged with Wardhana's evaluation, "Up to now the Government has been unable to exercise control over exports of oil under the exploitation of foreign monopoly capital. This results in a situation whereby the Government has foreign currency difficulties every year while foreign oil companies can smoothly transmit the oil proceeds abroad."[48]

The parliamentary committee's Chairman of Trade and Industry, Teuku Hassan, of proud Acehnese stock - those fiercely nationalistic north Sumatrans who had posed a formidable and prolonged challenge to Dutch power - drew upon the memories of his ancestors' war-cries by launching a systematic attack on the oil companies. Stopping short of a demand for nationalisation, a group of parliamentarians and non-parliamentarians joined Hassan to urge parliament to change the humiliating terms of the let-alone permits that had ceded the national patrimony and to control the oil majors' unbridled activities.[49]

Hassan's supporters were a mixed bunch: Maruto Nitimihardjo of Murba, Siauw Giok Tjhan of Baperki, I.R. Lobo of the Progressive Group, K.N. Tjikwan of Masjumi, A. Z. Abidin of the PSI and Muhammad Yamin. Siauw demanded that the government should cancel the "let alone" agreements, supervise the crude export prices, and forbid the oil companies from importing goods without foreign exchange controls.[50]

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[48] Review of Indonesia, 7 (July 1958), 22.

[49] Sutter, Indonesianisasi, vol.3, 820.

[50] Speech by Teuku Hassan, before the Dewan Perwakilan Rakjat(DPR), Government of Indonesia, Re: The Formation of the Mining State Committee (Panitia Negara Urusan Pertambangan), cited in Risalah Perundingan 1951 12 (2 August 1951), 1-7.

When governments are limited in their ability to organise and run the industry, demands for control do not necessarily translate into demands for nationalisation. Although there was a great deal of anger against the oil companies, even the most zealous Indonesian economic nationalists did not demand nationalisation. Even Muhammad Yamin, that staunch conservative-collectivist who had been a key supporter of increased state control during the constitutional debates, cautioned against the Iranian Prime Minister Mossadegh's failed precedent of confiscation and nationalization. Penrose emphasises that the meaning of "control" is nebulous: it may mean ending the power of the oil companies to take all strategic decisions or simply ending a "monopoly or monopsony."[51]

The number 65 came to occupy a sacred place in Indonesian oil industry history. Implemented only once from January to June 1952 until the famed 65:35 production-sharing agreements of the 1960's, economic nationalists evoked rationalisations to demand and defend it; the happy number was used by government spokesmen to suppress the true state of the government's tax arrangements with the companies; and corporate spokesmen conjured a dismal future in which a religious defense of sixty five percent would deprive Indonesians of their charmed presence.

A rumour, of obscure origin and premise, probably floated by the companies to neutralize support for the Hassan motion before it was debated in parliament, asserted that the "let-alone" agreements gave the government 65 percent of the companies' profits.

August 1951), 1-7.

[51] Penrose, The Large International Firm, 251.

On 2 August 1951 Teuku Hassan repudiated this assertion in his petition to parliament: while the oil companies claimed to make Rp 100 for a ton of North Sumatran petroleum products, Japanese buyers were willing to pay Rp 950.[52]

This was all the proof he had to make his case! Yet this was the beginning of the learning process, the beginning of an attempt to de-mystify the oil companies' activities. Hassan calculated that the state was annually losing 5 billion rupiah because the companies were reporting a fifth of their real earnings by inflating their operating costs and deflating realised prices for tax purposes.[53]

That day parliament unanimously passed the second part of Hussein's motion: to withhold new concessions until a new mining law was passed. This reflected the general consensus within and without government circles that it was necessary to shift the balance of power away from the companies in favour of the government. The premise was that rich revenues in the not too distant future were better than paltry revenues in the immediate future.

Parliament also created a State Commission on Mining Affairs (Panitia), established on 9 October 1951.[54] Its mandate was to draft a mining law in harmony with current conditions and grounded on a national economy; to consider disputes between the government and the oil companies; and to report its conclusions to the government in six months. The commission was representative of the prevailing political landscape and included spokespersons from the Economics and Finance ministries although P.K.I delegates were conspicuously absent.

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[52] Hassan, "Formation of State Mining," 1-7.

[53] Ibid.

[54] The commission was created by Government of Indonesia, Presidential Decree no. 8, 9 October 1951.

The Panitia first attended to Stanvac's "let alone" agreement which was to expire on 31 December 1951. On November 10 the Panitia recommended that Stanvac's "let alone" agreement should be replaced with a 65 percent profit share for the government. Stanvac and State Department officials resolved to halt the contagion, concocting a bitter pill for the Indonesian government to swallow to which they added some sweeteners.

Transnationals are unwilling to concede visible concessions to one host government for fear that it might set a precedent and trigger demands for similar concessions in other host countries. The maximum that the companies' representatives were prepared to offer was a 50:50 profit split based on realised prices. This was less than the Saudi government would obtain from Aramco under the fifty/fifty "posted prices" deal that was being negotiated with the aid of the U.S. State Department.

In late November and early December, Stanvac representatives asked the Panitia to postpone its decision while asking the American ambassador, H. Merle Cochran, to intervene. During the negotiations on the RTC, Cochran had served as a United States representative to the United Nation's Commission on Indonesia and had established amicable relations with the Sukiman cabinet. Using the classic carrot and stick strategy, in a series of meetings with Panitia Chairman Roem, the Minister of Economic Affairs Wilopo, the Minister of Foreign Affairs Achmad Subardjo, and Vice-President Hatta, Cochran alternately reminisced about their bond in the RTC negotiations and the "political danger" and "embarrassment" that the Indonesian government would face if

Stanvac's operational terms were changed. In their weakness and their fear of the repercussions of their actions, Indonesian government officials succumbed to the combined pressure of the U.S. government and Stanvac. In this encounter, even Stanvac's "let- alone" agreement did not expire as stipulated.

In the second round, the Ministry of Finance became the hub of negotiations since the foreign exchange regulations provided the framework for the division of profits between the government and the oil companies. More importantly, having failed to achieve a "fair" division of profits through its negotiations with Stanvac, the state sought to use general taxation measures to increase its revenues from the oil industry. In January 1952, the Ministry of Finance implemented a general progressive tax which raised the corporate tax to 50.5 percent, and in February it imposed a 25 percent export duty on "strong commodities" and 15 percent on "weak commodities" such as petroleum, tin, palm oil and coffee.[55]

But the oil majors refused to be treated like general corporations.[56] Oil corporations have always argued for and have generally received special treatment because of geological risk and uncertainty concerns. They have also traditionally used threats of reduced investments and less vigorous work programs to force host governments to withdraw their demands. This time it worked. The oil companies denounced the new taxes. Stanvac suspended its planned capital expenditures on 16

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[55] Benjamin Higgins, Indonesia's Economic Stabilization and Development (New York: Institute of Pacific Relations, 1957), 5-6.

[56] Senior Vice-President Finance, major oil company, interview by author, Jakarta, 23 Jakarta.

January 1952.[57] Stanvac executives warned Sumitro that it would cut production from 67,000 bpd to 50,000 bpd over the next three months and that it had begun to transfer some of its geologists to other countries. It asked the government to rescind the 15 percent export duty and to reduce the 8 percent export levy under the 5a contract to 5 percent.[58] Caltex sent a written protest to Prime Minister Sukiman and other cabinet ministers.[59] Divided in their perceptions about the implications of the tax, Royal Dutch/Shell executives awaited their implementation.[60] In a memorandum to the State Department Cochran described his conversation with Hatta:

> I told Hatta [that the] test has now come. I said that unless decisions [are] taken on present cases...to enable companies [to] feel they can go safely ahead in their plans, there would certainly be no further movement of private capital in Indonesia. I firmly stated that I would recommend against additional introduction [of] American capital under prevailing prospects. Indonesia [has] fallen behind in petroleum production and what is needed is not following [the] Dutch gouging practice of getting [the] maximum out of any concern.[61]

In April 1952, the Sukiman cabinet fell for abandoning Indonesia's independent foreign policy by signing the Mutual Security Act with the United States government; the Wilopo cabinet was installed; and the new Finance Minister Sumitro Djojohadikusomo was drawn into the negotiations with the foreign oil companies. By mid-1952, coupled with a recognition of the deeper economic malaise that the recession had brought in its train, economic nationalist though he was, Sumitro was unable to withstand the oil companies' pressure. He was forced to withdraw the new corporate taxes from the bargaining agenda. Now its policies were "directed towards providing incentives for export rather than raising revenues."[62]

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[57] Ibid.

[58] Ibid.

[59] Chairman, major oil company, interview by author, Jakarta, 7 February 1987.

[60] Ibid.

[61] Cable from American Ambassador in Jakarta to Secretary of State in Washington, 26 January 1952, cited in Aden, Oil and Politics, 127.

In this round the government gained two advantages for which Sumitro exultantly announced a victory. For the short term, from June to December 1952, the government received 65 percent of gross profits after costs and depreciation were deducted. For the first time LAAPLN - the Indonesian government's foreign exchange agency gained control over net foreign exchange proceeds - the difference between gross revenues from petroleum exports and payments for petroleum imports and operating costs.[63] Yet, in 1952, the oil industry contributed nothing to Indonesia's international balance of payments because the outflow of capital for imports, profits and depreciation for the oil industry equalled the foreign exchange earned by the industry.[64] Sixty five percent of zero was indeed, a poor victory. No long-term profit-sharing agreement emerged in this round.

In the third round, although the government was forced to shelve its demand for 65 percent of gross profits, the government's bargaining power increased moderately. It was not an acrimonious encounter. The government's demand for a 50/50 profit split coincided with the oil majors' decision to yield since they maintained the sanctity of their contract: they merely reverted to the original 5a concession contracts of the colonial period. It was, after all, a better deal for them than the Middle Eastern 50/50 "posted price" formula.

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[62] Higgins, Economic Stabilization, 5-6.

[63] Ibid.

[64] The government's receipts from the oil industry were 4.4. million rupiah and zero for 1951 and 1952 respectively whereas payments constituted 406.2 million rupiahs and 608 million rupiahs for the two years. Figures at Bank Indonesia Report cited in Higgins, Economic Stabilization, 150.

In 1953, the government issued a decree that invalidated the "let alone" agreements by ending the free depreciation facility. Capital expenses had to be capitalised, divided into categories with specified economic lives and depreciated accordingly. As a concession, the companies could defer depreciation for three years.[65] A company could depreciate capital expenditures for 1954 in 1955, 1956, or 1957.[66]

> The effective split under the let alone arrangements had been 60/40 in favour of the companies. The government wanted to achieve a 50/50 split like the Saudi formula. The decree allowed untaxed, accelerated depreciation of 8 percent per annum. So the government arrived at roughly a 50/50 profit split based on realised prices.[67]

The government gained three advantages in this round. It achieved a rough 50/50 profit split to replace the 60/40 profit split that had favoured the oil companies.[68] At least formally the Ministry of Economic Affairs and LAAPLN could issue price directives with "prior consultation and concurrence of the oil companies."[69] It was as yet a formal right but it was better than no right. And the government obtained a guaranteed monthly salary from the oil companies - they calculated taxes and transferred dividends every month. For its non-confrontational approach in this round, the companies rewarded the government with promises of new investments over the next five years: Royal Dutch promised 30 million pound sterling, Caltex pledged $60 million in rupiah expenditures alone, and Stanvac guaranteed $70-80 million.[70]

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[65] Senior Vice-President Finance, major oil company, letter to author, received 31 May 1989.

[66] Ibid.

[67] Ibid.

[68] Former accountant, major oil company, interview by author, Jakarta, 26 February 1987.

[69] Letter from J.C.G. Boot, General Representative, N.V. De Bataafsche Petroleum Maatschappij to the Management of Lembaga Alat-Alat Pembajaran Luar Negeri, Government of Indonesia, Jakarta, January 18, 1956. See also Lembaga Alat-Alat Pembajaran Luar Negeri(Institut Divisen), Re: Approval of Foreign Exchange Permit to N.V. Caltex Pacific Petroleum Maatschaapij, letter No. Sekr/53/3888, Djakarta, 14 May 1954. See also Lembaga Alat-Alat Pembajaran Luar Negeri(Institut Divisen), Re: Approval of Foreign Exchange Permit to N.V. Standard-Vacuum

In every other sense, the new permits merely reconfirmed the let-alone permits. The companies were the bookkeepers, retaining control over all "foreign currency obtained from exporting crude oil, oil products, materials, equipment and from freights and services rendered," and presenting their "estimated" tax obligations to LAAPLN which immediately granted special licenses to transfer those earnings abroad in the form of depreciation and profits. Crude and petroleum exports would be evaluated at realised prices.[71]

Once established these arrangements stayed in place until the contract of work was negotiated in 1963. The new depreciation schedule brought the government some stability in its foreign exchange earnings from the oil industry. Yet, roughly 50 percent is not fifty percent. A new round of bargaining was therefore, necessary. In 1955, under

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Company, Letter No. Sekr/112/7323, Djakarta, 10 September 1954. See also Lembaga Alat-Alat Pembajaran Luar Negeri(Institut Divisen), Re: Approval of Foreign Exchange Permit to the Royal Dutch/Shell Group of Companies, letter no. Sekr/33/407, Djakarta, 18 January 1956.

[70] Ibid; Vice-President Finance, major oil company, interview by author, Jakarta, 23 February 1987.

[71] Letter from J.C.G. Boot, General Representative, N.V. De Bataafsche Petroleum Maatschappij to the Management of Lembaga Alat-Alat Pembajaran Luar Negeri, Government of Indonesia, Jakarta, January 18, 1956.

in its foreign exchange earnings from the oil industry. Yet, roughly 50 percent is not fifty percent. A new round of bargaining was therefore, necessary. In 1955, under pressure from the Communist party to nationalise the oil industry, the Kantor Minyak was established under P.M. Djuanda to determine whether the production or profit sharing arrangement should be adopted.[72] But the negotiations between the oil companies and the government took place after the PRRI rebellion.

Section IV

The years 1957 and 1958 saw some major political and economic changes in the Indonesian landscape. From the perspective of the oil industry the PRRI rebellion was a significant event for a number of reasons. With the rebellion the deep-seated dissatisfaction in the Outer Islands came to a head. Outer Islanders and disaffected Jakarta politicians were prepared to use foreign military aid to overthrow the Indonesian government or at least make it toe a pro Western line. And the major oil companies seemed prepared to support an alternative government that would provide the political stability necessary to enhance the security and profitability of their operations.

At the beginning of 1957 almost all of Sumatra was in open revolt against Jakarta.[73] The anger against the central government was not a new phenomenon. Since 1950 Java had been accused of colonising and exploiting the Outer Islands. By early 1957, the regionalist demands had been transformed into demands for a radical transformation of the political order, a direct response to Sukarno's appeal to establish his version of Indonesian democracy, Guided Democracy, by ending the party system and giving the long deprived PKI a role in government.

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[72] Former senior government lawyer, interview by author, Jakarta, 6 February 1987.

[73] For an excellent discussion see Ulf Sudhaussen, Road to Power: Indonesian Military Politics 1945-1967 (Kuala Lumpur: Oxford University Press, 1982), 107-11, 122-146, 166, 180.

The take-over of Dutch enterprises in December only served to augment the fear of the PSI and Masjumi that Indonesia was heading towards the left. Their leaders, all economic nationalists, headed by former Masjumi and PSI Premiers and Cabinet Ministers - Sjafruddin Prawinegara, Sumitro Djojohadikusomo and Barhanuddin Harahap - sought to prevent a reduction in their power base and to render the PKI powerless by declaring war on Jakarta.

On 15 February 1958, Sjafruddin Prawinegara, a former Director of the Bank of Indonesia, established a new government with its headquarters in Padang in Central Sumatra. It aimed to defeat the central government through economic warfare - depriving it of Sumatra's export revenues. One of the biggest oil fields in the world, Minas, is located in the Pakenbaru region, 100 miles northwest of Stanvac's Lirik oilfield. Sumatra's oil industry alone brought the government $108 million dollars in revenues.[74]

Throughout March there was tension in the air in the midst of conflicting statements. Prawinegara announced that he had asked Caltex to divert Jakarta's share of taxes, royalties and foreign exchange earnings to the new government.[75] Caltex hotly denied its willingness to do so.[76] The American government offered to aid the Indonesian government in protecting American lives and property. It also asked the

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[74] New York Times, 3 March 1958.

[75] New York Times, 1 March 1958.

[76] New York Times, 5 March 1958.

Indonesian government for permission to move American warships from Singapore and land American paratroopers in Pakenbaru.[77] General Nasution and the central government saw this as a thinly veiled threat of intervention and summarily refused the offer and request. In Nasution's mind, the threat of foreign intervention required that the PRRI rebellion must be instantly quelled by force.[78] By the end of March the rebels had been defeated.

Why were the leaders of the PRRI seen as traitors? What made the central government's claims to Sumatra's export revenues superior? After all, the PRRI leaders had participated in the Indonesian struggle for independence. As central government authorities, they had bargained as hard as they saw possible, perhaps not successfully, to achieve Indonesia's national interests with the Dutch and with the oil companies. They were economic nationalists whose vision of economic development necessitated Western aid and expertise.

As long as the notion of the nation-state retains its validity, one entity will emerge victorious over the other. The ultimate sources of a nation's legitimate claims to statehood lie in its victory and its prior claims as they are interpreted by the international community at any given moment. The vision of a united Indonesian state, a vision which united the communists and the army leadership, tolerated no divisions. A call for fragmentation by a group of Western-oriented Sumatrans who were supported by the United States C.I.A. was tantamount to sacrilege; its perpetrators were rebels. This was the centralist position. "Nationalism appeals because it alleges society and state to be a unitary whole; what government does is in behalf of the national interest. But this is an illusion."[79] Yet, who would dare dispute or sit in subjective judgment on the legitimacy of superior claims - claims that mixed blood, sweat and tears with imagined community? Aided by fortune, force became the ultimate arbiter.

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[77] New York Times, 23 March 1958.

[78] General A. H. Nasution, former Chief of Army-Staff, interview by author, Jakarta, 12 March 1987.

All Indonesian centralists viewed the American government's offer to intervene in the PRRI crisis as a challenge to Indonesian sovereignty and self-respect. Famed for his oratorial prowess and the catchy titles that he gave to his speeches, Sukarno bitterly denounced the Western world's inability to comprehend Asian nationalism in his 1958 speech, "A Year of Challenge", delivered in the aftermath of the PRRI crisis.

> It would be well for the Western world to realise that Asian nationalism is a historic necessity. We should, in the course of developing this nationalism, like to be left alone but the Western countries are always trying to obstruct us. They seem to want to make us like themselves, with the result that there are always tensions between the West and the countries of Asia. We have always called for co-existence between the communists and the anti-communists blocs, and now we call on the Western countries for co-existence between them and us.[80]

The PRRI rebellion would actually weaken the bargaining power of the oil majors, especially when it became publicly known that the United States C.I.A. had abetted the so-called rebels. For a while, the army had been capturing American weapons which were being dropped by foreign aircraft, a fact that it had not publicised to prevent

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[79] Larry Pratt, "Up From Nationalism," in Social Democracy Without Illusions: Renewal of the Canadian Left, ed. John Richards, Robert Cairns and Larry Pratt (Toronto: McClelland, 1991), 149.

[80] "1958, A Year of Challenge," Independence Day speech by President Sukarno cited in Review of Indonesia, September 1958, 9-11.

Indonesia from becoming embroiled in open super power rivalry. But on 19 May 1958, a plane of that infamous institution, the C.I.A., was shot down.

On that day, General Nasution, personally took to task the United States embassy's Defense Attache, a perturbed George Benson. He, now more Indonesian than American, fondly recounts how an irate Nasution greeted him with a vitriolic barrage, delivered interchangeably and with aplomb, in Dutch, English and Bahasa Indonesia, portraying the humiliation and anger that Indonesians had experienced.[81] Caltex was also implicated in the rebellion. A later Indonesian Defense Department document confirmed that on 16 November 1957, a ship owned by Caltex, the Caltex Bengkalis, carried eight chests of ammunition to Pakenbaru to aid the rebels.[82]

In the Indonesian mind the presence of the foreign oil companies became permanently linked to the threat of foreign intervention. It was this link, articulated as the inextricable relationship between political and economic imperialism, that the PKI leadership sought to popularise in its campaign against the oil companies and which gained legitimacy following the PRRI crisis. On 17 July 1958 the Communist Party's People's Daily denounced Djuanda for introducing a foreign investment bill that reaffirmed the views of the "ousted rebels Sumitro and Barhanudin Harahap", and negated the Indonesian rationale for abrogating the RTC agreements in 1956.[83]

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[81] George Benson, former Defence Attache, U.S. Embassy Jakarta, interview by author, Jakarta, 19 February 1987.

[82] Departmen Hankam, Sejarah Operasi-Operasi Gabugan Terhadap PRRI-Permesta, 1971, 23, cited in A.H Nasution, Memenuhi Panggilan Tugas, vol.4 (Jakarta:Gunung Agung, 1984), 228-29.

[83] Review of Indonesia, July 1958, 25, 29.

Section V

The dissatisfaction with the oil companies' profits, and the parallel foreign exchange difficulties that they represented for the Indonesian state, remained a universally sore point. With the Masjumi and Socialist parties emasculated, the PKI became a more vocal and powerful force but it still remained on the political establishment's fringe, conducting its critique from without. The PKI's position on the oil industry is lucidly summarized in a pamphlet written by Chairman Aidit in 1963. He argued that it posed a constant threat of intervention and subversion. Noting that Shell, Stanvac, and Caltex had spent U.S.$ 84 million, $40 million and $47 million since 1954,[84] Aidit warned that American economic imperialists, "the most aggressive, rapacious, and brazen of all imperialists,"[85] were "expand(ing) and strengthen(ing) their economic basis...in Indonesia."[86] New investment and expanding production did not benefit the government because it did not control the oil companies foreign exchange earnings.[87]

In the late 1950s the debated question was not "whether" but "how to" re-negotiate the oil companies' contracts.[88] As Sutowo remarked:

> We hated the concession system as much as we hated colonialism. Ideally

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[84] D.N. Aidit, Dare, Dare, Dare Again, Political Report Presented on 10 February 1963 to the First Plenary Session of the Seventh Central Committee of the Communist Party of Indonesia, (Peking: Foreign Languages Press, 1963), 36-37.

[85] Ibid., 7.

[86] Ibid., 36.

[87] Ibid., 28, 36-37.

[88] Ibnu Sutowo, former President-Director Pertamina, interview by author, Jakarta, 15 January 1987.

> we should have introduced a production-sharing contract. But we could not impose it unilaterally on the companies. We were very clear about one thing - management of oil resources should stay in Indonesian hands. We were prepared to bargain on matters of economic rent but we were not prepared to negotiate on the issue of national control. As far as we were concerned the oil companies had no mineral rights since they belonged to the Indonesian nation.[89]

In this encounter from 1958 to 1963, the bargaining took place in two rounds. In the first round, the Indonesian government persuaded the oil companies to accept the principle of a 60/40 profit split in its favour. In this round, the government used a number of strategies to enhance its bargaining power with respect to the oil companies. It created and invited competition. It passed new legislation to claim natural resource ownership, it created state-owned companies, it started developing a bureaucracy with some understanding of the oil industry. It also utilised the growing Communist demand for nationalisation which gave it the image of being more moderate and reasonable. As Mikesell argues, "the growth of the industry itself generates increased bargaining power for the government. As the foreign-controlled industry becomes more important in the economy, it becomes an object of attack by political forces opposing the government in power."[90]

After three years of negotiations the oil companies gave in to the 60/40 profit split in principle. As Moran and Mikesell argue, transnationals are particularly vulnerable when they have made huge investments and are not planning new ones. The oil majors were particularly vulnerable because they had already made considerable investments and were not contemplating large new investments. They were also afraid that if they ignored the demands of the more moderate government, they might have to make greater concessions to a more leftist government or even find their operations eventually expropriated.

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[89] Ibid.

[90] Mikesell, "Investor-Host Country Relations," 39.

In the second round, the issues were much more contentious because the host government was not only making demands for higher revenues but it was seeking to undermine the premises of the oil majors' oligopolistic edifice. It was moving higher on the learning curve; it was questioning the manner in which the oil companies were operating and it wanted to partake in strategic decision-making since it was footing a part of the bill.

The companies found it extremely difficult to swallow this, even to the point of considering withdrawal. The domestic political scene was heated, anti-imperialist emotions were running high in the midst of the Irian Jaya conflict, demanding stern actions against the oil companies. The oil companies and the government were unwilling to back down. But a joint-maximisation outcome was eventually achieved with the US government's timely intervention. As it will presently be demonstrated, the Indonesian state's bargaining power had increased and by mid-1963 it had taken definitive strides on the "learning curve" although it did not achieve all of its objectives.

In the first round, the oil companies had productive and sunken commitments, the PKI was demanding nationalisation, Guided Democracy had provided the basis for greater state intervention into the economy, state decision-makers were able to rule by decree, and the desire to change the terms of the original concession became urgent. The state became more assertive and the sense of injustice against the oil companies increased.

By the late 1950s posted prices were artificially high, "which increased the profit share of the (Middle Eastern) host governments and it gave them an interest in maintaining posted prices for crude oil."[91] But since the Indonesian government, like the Venezuelan government, received profits based on realised prices, if the company discounted crude oil sales, the Indonesian treasury bore roughly 50 percent of the reduction.[92] This became a common phenomenon towards the end of the 1950s as the oil market became over-supplied. All these factors raised the sense of injustice among Indonesian decision-makers and led to demands for a greater share of rent. As Vernon notes:

> A pronounced change in outlook can be expected to occur, however, after the initial exploration has been completed. The projects that fail drop out of sight, their cost borne partly by foreign investor and partly by his tax authorities at home. The projects that succeed take the limelight; what was once a wistful hope becomes a tangible bonanza. The level of risk associated with the enterprise, as perceived by the parties, drops precipitously. ...The returns to the foreign company no longer seem appropriate to the risk, and the government feels justified in demanding more out of the project.[93]

The state did not seek nationalisation. "The driving force behind cooperation with the industry was to transform Indonesian riches into a reality, to get higher rents."[94]

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[91] Hartshorn, Oil Companies, 317.

[92] Former chief legal counsel, major oil company, interview by author, Jakarta, 17 February 1987.

[93] Vernon, Sovereignty at Bay, 55.

[94] Tirto Utomo, former head of Pertamina's Legal Division, interview by author, Jakarta, 6 February 1987.

Vernon notes that state decision-makers pursue two contradictory objectives: to keep the "egg-laying goose" alive and to maximize egg-extraction to remain politically alive. Over time they favour the first objective over the second.[95] Penrose argues that a rational host government seeking to maximise its revenues from the oil industry will only threaten to nationalise oil companies if it can replicate their functions at an equally profitable rate.

While preserving the goals that arose from the ideology of national control, the Indonesian government adopted a more pragmatic approach to promote joint-maximisation strategies with the oil companies that would bring the state enhanced revenues without leading to an absolute decline in oil revenues for both parties.[96] "In the late 1950s our basic interest was to accumulate knowledge about the oil industry. The most difficult thing was to produce and sell the oil."[97]

> We did not seek nationalisation because Ibnu and Cheirul Saleh agreed that the international majors should not be touched since we could not run the oil industry without them. The Communist Party felt that we were not nationalistic enough. But unlike the Middle Eastern countries, we wanted to adopt a non-confrontational approach in bargaining with the oil companies.[98]

While the host country may lack the skills to operate its resource industry alone and to market its products independently, it can increase its bargaining power by finding competitors - independent petroleum firms, national petroleum firms in developed countries, and/or it may create its own state enterprises to invade the established transnationals' barriers to entry. "...increased competition in the supply of specialised factors needed for resource exploitation and marketing, which were once the preserve of a few international companies, reduces the long-run supply prices of these factors."[99]

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[95] Vernon, Sovereignty at Bay, 194.

[96] For a theoretical discussion of this issue see Mikesell, "Investor-Host Country Relations," 41-42.

[97] Ibnu Sutowo, former President-Director Pertamina, interview by author, Jakarta, 15 January 1987.

[98] Former senior government lawyer, interview by author, Jakarta, 6 February 1987.

In the international oil industry, the oligopoly of the majors was gradually being eroded by independent companies and governments.[100] Japan and other oil importing countries were seeking cheaper and alternative sources of supply. In the iate 1950s and early 1960s, the Seven Sisters tended to be myopic about the long-term impact that these new firms might have on their control over the oil industry. But the emergence of new firms and new buyers created an avenue for the oil exporting countries to cause a dent in the oil majors' oligopolistic control over international oil markets. This factor gave host governments some bargaining leverage with respect to the oil majors.

Beginning in 1958, the Indonesian state decision-makers took a number of measures to strengthen their bargaining power. In 1958 the state abruptly cancelled the 1953 depreciation agreements.[101] It established a Ministry of Mines in 1959 to draft a mining law to replace the colonial mining law to serve as a stepping stone to replace the 5a concession agreements. To end the prolonged parliamentary debates that had continued for ten months, Sukarno proclaimed the draft as Government Regulation in Lieu of Law

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[99] Mikesell, "Investor-Host Country Relations," 40.

[100] For a good discussion of this issue see Jacoby, Multinational Oil, 93-103, 122-149.

[101] Chairman, major oil company, interview by author, Jakarta, 7 February 1987.

No. 44 of 1960 on 26 November 1960.[102] "The 1959 Decree took us back to the Constitution of 1945. It was the first step to abolishing all the regulations applying to the oil industry established during the Dutch period. This law became the basis for the negotiations with the oil companies."[103]

With Guided Democracy the state became a more direct participant in the oil industry, making inroads into the oil majors' oligopolistic control over Indonesian oil production and exports. In 1957, Nasution had ordered Sutowo to rehabilitate the old BPM facilities which had brought the army some revenues from spot sales.[104] The Indonesian state-owned companies sought alternative buyers and were producing small quantities of oil. As Sutowo proudly proclaims, in 1957 he made $35,000 on his first spot sale to an American trader, Hutton.[105]

Cheirul Saleh began negotiations on a technical assistance agreement with Romania for oil exploration and development. Challenging the majors, in 1961 the government signed a 60/40 profit sharing agreement with the Canadian independent company Asamera. In 1961, Indonesia joined OPEC, to learn from its more practised fellow states, how to bargain with the oil companies. In addition, a bureaucracy was being developed with the skills to understand the intricacies of the oil industry, albeit with the aid of the oil majors, particularly Caltex.

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[102] High-ranking government official, interview by author, Jakarta, 2 January 1987.

[103] Former high-ranking government lawyer, interview by author, Jakarta, 23 January 1987.

[104] General A. H. Nasution, former Chief of Army-Staff, interview by author, Jakarta, 12 March 1987.

[105] Ibnu Sutowo, former President-Director Pertamina, interview by author, Jakarta, 15 January 1987.

The state seeks to publicise its demands to increase its bargaining power with the transnationals. On 29 April 1961 Cheirul Saleh notified the companies that they would be allowed to remit their profits abroad but they had to give the state 60 percent of the profits, follow a ten year depreciation schedule to calculate taxes, and contribute a proportion of their oil production for domestic consumption.[106] "The reason why they came up with 60 percent was that they thought that by removing the tax-free 8 percent accelerated depreciation allowance, they would get approximately 60 percent of the profits."[107] On 29 August 1961, in Presidential Decision Presidential Decision 476 Sukarno reiterated Saleh's demands.[108] In November 1961, Cheirul Saleh told the New York Times, "The government stands firmly behind its decision to get a 60/40 ratio and also firm in its efforts to develop a nationally owned industry despite the difficulties created by the necessary investment."[109]

Transnationals seek to neutralise the sources of the government's increased bargaining power with the following tactics: they stall; they offer to make new commitments; they threaten to reduce their investments and/or production; they threaten to terminate their activities; they enlist the support of their home government whenever and if it is available. They continue to capitalise on the strengths that make the host government dependent on their services - their superior technical, financial, and marketing skills - and which prevent host governments from making a credible threat to nationalise the industry.

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[106] Vice-President Finance, major oil company, interview by author, Jakarta, 23 February 1987.

[107] Ibid.

[108] Ibid.

[109] New York Times, 18 November 1961.

The oil majors were fully cognizant of the Indonesian state's inability to make a credible nationalisation threat. As one major oil company executive described it:

> The major question for the government was how it would run the oil industry and sell the oil. We were aware of the government's weakness when we negotiated our contract terms in the pre-1963 period. Those within and outside the government who demanded nationalization had very little understanding of the dominant position enjoyed by the oil companies in world oil markets.[110]

Therefore, the transnationals sought to maintain the status quo. At first, they stalled. They refused to accept the government's demand for a 60/40 profit-sharing deal based on posted prices. Caltex, however, offered to invest $60 million in the next decade and it admitted that "growing public rejection" necessitated new foreign exchange licensing procedures.[111] But by 28 August 1961, in response to Presidential Decision 476, oil company spokesmen told the New York Times that if the new decree was "implemented the plants would operate under a sixty/forty basis, but may not get maximum output under the new working conditions."[112] Indonesia would be a poor candidate for investment compared to more attractive climes in the Middle East.[113]

While the companies preferred to maintain the status quo they were willing to concede to a 60/40 deal rather than liquidate their assets. While they continued to capitalise on their strengths, they were not threatening divestment. Their sunk investments had made them vulnerable. This had been the case since 1958 when the Indonesian government had abruptly cancelled the oil companies' depreciation permits. "At a shareholder's meeting in New York, it was decided that Caltex should negotiate rather than divest because of its huge sunken investments."[114]

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[110] Chairman, major oil company, interview by author, Jakarta, 7 February 1987.

[111] Letter from Caltex Pacific Indonesia to First Minister Djuanda, dated 5 December 1960.

[112] New York Times, 29 August 1961.

[113] Ibid.

Populism enhances the government's bargaining power. Governments are forced to show that they are taking stern actions to control the transnationals' exploitative forays and to obtain a more "equitable" profit share. While the Indonesian government did not concede to the Communist Party's demands for nationalisation, it used those demands to enhance its bargaining power with the transnational oil companies. Sukarno and Cheirul Saleh could appear moderate compared to the Communists. "The companies recognized that President Sukarno might not be able to control the nationalisation tide so it was better for them to make a deal with him. If they did not cooperate with him the labour unions might take-over and they would get a worse deal."[115]

Companies do take cognizance of the potential emergence of a more leftist or populist government that might be less sympathetic towards them. Foreign investors react to populism with fear. "The threat of what in the literature of game theory is called 'a warfare solution' brings the companies to accept a less favourable share than might otherwise be the case. Populist forces are bound to make a foreign company more reasonable in reacting to government demands."[116] Companies will prevent warfare solutions if they expect major gains from their continued presence in the country. But they never do so without a struggle.

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[114] Chairman, major oil company, interview by author, Jakarta, 7 February 1987.

[115] Former high-ranking government lawyer, interview by author, Jakarta, 6 February 1987.

> At a moment when the companies had just finished a large lump investment and would not be willing to make any further commitment for some time, they would be particularly vulnerable. If this coincided with a moment when [some] most domestic groups identified their own interests with expulsion rather than preservation of the foreign presence in the industry, the result for the companies would be sharper than a serpent's tooth.[117]

At least publicly, the companies tend to make a show of making major concessions to the government, even if these concessions are not in reality as magnificent as they appear. In December 1961, the New York Times reported that the oil companies' five parents and the Indonesian government had agreed to the principle of a 60/40 split favouring the government.[118] In the following months the companies submitted versions of a 60/40 split since the presidential decree did not specify how it was to be achieved. Eventually the Caltex draft would serve as the model for formal negotiations.[119]

The companies' representatives understood that the government could not back down on its demand for 60 percent of the profits and the ownership clause which had been exultantly presented to the media on numerous occasions. They set about the task of crafting a contract which involved re-writing the existing legal and accounting paraphernalia without undermining the companies current profitability. This version would free the oil companies from all Indonesian taxes, duties, imposts and governmental exactions related to petroleum operations. "The companies indicated that if all the taxes were added up then the government could get a clean 60/40 split."[120]

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[116] Mikesell, "Investor-Host Country Relations," 39.

[117] Moran, Politics of Dependence, 126-127.

[118] New York Times, 13 December 1961.

[119] Vice-President Finance, major oil company, interview by author, Jakarta, 23 February 1987.

Once the companies had agreed to a 60/40 arrangement in principle the question that remained was how it was to be achieved. It was this factor that became the subject of acrimonious debate, to be resolved only by the timely mediation by the U.S. State Department.

Section VI

> Most problems arising in the bargaining between companies and governments raise two types of issues: those involving economic and financial advantages and those involving principles. The former are more negotiable than the latter, for on principles it is more difficult to achieve "compromise with honour" than on money.[121]

Ultimately the issue of control translates into the issue of greater revenues. When a host government wants the transnational to subsidise the domestic market; when it questions the value at which a transnational sells its oil or if it wants to market its own share of oil, all these issues boil down to one theme - the state wants to know how much revenue is actually available and how much economic rent it can derive without killing the egg-laying goose. The Indonesian government had several objectives aimed at improving its share of revenue.

The Ministry of Mines' negotiating team was led by Lukman Hanafiah and Tirto Utomo, who were both lawyers. For four long years, Hanafia and Utomo had probed and learnt the complexities of the industry with the assistance of Caltex's legal team led by Del Yuzar.[122] This is an expected outcome in the bargaining literature. Over time, the state will develop the expertise to understand the workings of the industry, even with the aid of transnational corporations. Information will be disseminated to the host country.

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[120] Ibid.

[121] Penrose, The Large International Firm, 211.

Caltex may have the reputation of being the most thrifty of the oil majors, but its parsimony has led it to be also the least ethnocentric of the oil companies. Since the late 1950s it had begun to hire Indonesians in top management positions. And it was with these Indonesians that the government bureaucrats felt most comfortable in their learnings about the oil industry and their parleys over future revenues for the state.[123]

The Hanafiah team first sought to lay a claim to the mineral rights. The state gains an economic interest in the natural resource from certain intangibles such as state ownership.[124] "The contract of work clarified the definition of the negotiable and non-negotiable aspects of our relationship with the oil companies. Art. 33 of the Constitution was definitely a non-negotiable clause. We were not prepared to bargain on this clause with the companies."[125] From this intangible interest, the state claimed ownership and control over the natural resources.[126]

A classical issue in the management and control debate was how would

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[122] High-ranking government official, interview by author, Jakarta, 2 January 1987. Also high-ranking corporate lawyer, interview by author, Jakarta, 17 February 1987.

[123] Ibid.

[124] Former high-ranking government lawyer, interview by author, Jakarta, 30 January 1987.

[125] Ibid.

[126] Ibnu Sutowo, former President-Director Pertamina, interview by author, Jakarta, 15 January 1987.

> the government be able to manage and control the operations and evaluate the work program when we did not have the expertise to drill a well and the financial capability to run the industry on our own. Consequently, transnationals had to be contractors to the state.[127]

To obtain the true value of Indonesian crude as opposed to the realised price quoted by the companies, the Indonesian government wanted to prevent the oil majors from selling crude to their affiliates.[128] Instead, it wanted them to conduct arm's-length transactions since realised prices "for intra-firm sales are largely a matter of accounting practice."[129]

> The size of the oil companies gave them the power to exercise integrated and oligopolistic control over Indonesian oil exports. We wanted to prevent them from selling their products to affiliates. We also wanted them to become contractors to the state so that we could gain a window on their operations.[130]

The host government was seeking to undermine a key feature of the oil companies' profit making strategies and the benefits that it derived from internalisation and vertical integration - intra-firm transfer pricing. "This was not in our interests and we did not feel that we needed to make such concessions."[131]

The Indonesian team wanted the option to lift its share of crude in kind. Simultaneously, it sought to reduce its risks by ensuring that the oil majors would sell the government's share of crude if it had no alternative markets. In this way, the state-owned companies could try their hand at climbing the oil marketing "learning curve" with a safety net. The government had gained confidence because of the state-owned companies' successes in making sporadic spot sales. "We hated those spot sales with a passion because we were undermined in our own markets. Nor were we willing to stop intra-firm trade. We tried to dissuade them with the warning that they might find it difficult to find markets."[132]

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[127] Former high-ranking government laywer, interview by author, Jakarta, 30 January 1987.

[128] Former high-ranking corporate lawyer, interview by author, Jakarta, 17 February 1987.

[129] Mikesell, "Investor-Host Country Relations," 44.

[130] Former high-ranking government lawyer, interview by author, Jakarta, 23 January 1987.

[131] Former high-ranking corporate lawyer, interview by author, Jakarta, 17 February 1987.

In previous years, as it has been seen, the oil industry had not brought the government assured annual revenues. The Indonesian government had no control over the revenues that the oil companies ploughed back into the home country for imports, profits, depreciation and dividends. It had no market measure to determine whether many of those costs were reasonable. The Indonesian negotiating team wanted to limit the companies annual deductions for cost recovery, reduce their marketing costs and to take part in monitoring the companies expenses to determine whether they were deducting reasonable costs. The companies had been paying taxes on the basis of the realised price calculated from the point of sale. Thus, the government had to bear a share of the cost of freight, a fictitious figure, because "we sold oil directly to our affiliates."[133] Now the government wanted the oil companies to use the f.o.b export price as the basis for calculating taxes.[134] It also wanted to obtain a guaranteed annual share of production in kind.[135]

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[132] Ibid.
[133] Ibid.
[134] Ibid.

Finally, the government wanted to reduce oil imports and provide a stable domestic supply at subsidised rates.[136] It was politically essential to deal with domestic shortages. As part of the Communist party's anti-imperialist tirade, the front cover of The Review Of Indonesia September 1963 issue had pictured a lampoon with little children and housewives carrying empty kerosene bottles while the oil majors drove away with the country's oil. The state would be able to pursue its non profit-oriented political goals by subsidising domestic oil consumption. For this, it sought to monopolise domestic marketing and distribution by taking over the refining and distribution facilities of Shell and Stanvac since they exported much of their product at market prices.[137]

These demands were not irrational. Talking to Fortune after the contract of work was signed Jack Rathbone, Jersey Standard's chief executive said, "Considering that we have been negotiating with a government that is both irascible and irrational, I'm contented with the way this has worked out."[138] Yet, which oil major, or for that matter which liberal economist would pay bills without asking for receipts? And which liberal economist would not laud a spirit that seeks to enhance profits, albeit a public one? But the oil majors and liberal economists expected host governments such as Indonesia to "trust" them for their goodwill and honesty. Besides as Penrose notes,

Because xenophobia is often used as a scapegoat for domestic troubles,

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[135] Vice-President Finance, major oil company, interview by author, 11 May 1987.

[136] Ibnu Sutowo, President-Director Pertamina, interview by author, Jakarta, 15 January 1987.

[137] Ibid.

[138] "Business Around the Globe," Fortune, August 1963, 79.

> there is a tendency among Western observers to put this entire complex of attitudes and behaviour into the box labelled irrationality. It is of course "irrational" of economists to label other people's preferences as irrational provided those preferences are consistent and their implications are appreciated by those who express them.[139]

The Hanafiah team had also introduced a competitor to challenge Caltex. On 15 June 1962, Pan American was granted a contract-of-work adjacent to Caltex's central Sumatran concession. It was a thirty year contract. The government would get 60 percent of the profits, a proportion of crude for domestic consumption at 10 percent below the f.o.b. market price, and it had the option to lift 20 percent of total production in kind. But even this ploy did not work.

So on 26 April 1963 Sukarno issued an ultimatum to the oil companies which was publicised on 14 May 1963: they could renegotiate their contract by 15 June or liquidate their operations in five months. Mikesell argues that a large firm with a large commitment and large profits should react more magnanimously to a host government's demands when it perceives that its bargaining power is reduced.[140]

But the oil companies did not feel that their bargaining power was at such an ebb that it required the concessions that the Indonesian government was demanding. "The Indonesian government sought to achieve its aspirations by imposing constraints on us. We told them that we could prevent them from achieving their aspirations by halting oil production, their sole source of revenue."[141] When transnationals are aware of the government's unwillingness to nationalise the oil industry, they seek to maintain the status quo. On May 17 Standard of California and Texaco representatives told Deputy Secretary of State for the Far East, Averell Harriman, that they needed State Department intervention to help them maintain the "sanctity" of their contracts because the new terms would force them to withdraw:

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[139] Penrose, The Growth of Firms, 126.

[140] Mikesell, "Foreign Investor-Host Country," 44.

[141] Former high-ranking corporate lawyer, major oil company, interview by author, Jakarta, 17 February 1987.

> Companies exploit their initial bargaining advantage not only to exact high initial returns but to cement the initial asymmetries of power through long-term concessions. From the perspective of the corporation the concession - with its paraphernalia of "sanctity of contract" and guarantees of stability and "inviolability" - is intended to postpone the erosion of its monopoly power and slow the cumulative shift in bargaining advantage towards the government.[142]

Having publicised his ultimatum, Sukarno could not back down in the current domestic situation when the Communist Party was denouncing his government for having succumbed to imperialist pressures by accepting I.M.F./U.S. government aid. In fact, it was because of the long-drawn-out negotiations and the need to give public testimony to the fact that the government was seeking to reduce imperialist influence that Sukarno had issued the ultimatum. The oil majors and Sukarno had reached a stalemate in which it was easier for the oil companies to back down.[143]

> Both the company and the government may be well aware of the government's fundamentally weak position if the battle lines are drawn, but the position of the parties is such that, when the company refuses to yield to its final demand, the only thing the government can do is to threaten nationalisation(or ask for liquidation). Once it makes such a threat

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[142] John Richards and Larry Pratt, Prairie Capitalism: Power and Influence in the New West (Toronto: McClelland and Stewart, 1979), 73-74.

[143] For such an argument regarding Argentina during the Frondizi period (1958-63) and the Frei government's Chileanization program see Mikesell, "Investor-Host Country Relations," 43-44.

> publicly, it may easily become a prisoner of its own acts and be unable to back down, ...and this puts great pressure on the moderate members of the government and strengthens the position of the more extreme members.[144]

It was this fear, the fear that the Sukarno regime might be toppled by the Communist party which would gladly nationalise the oil companies, that caused the U.S. State Department to blink, in defense of the national interest. The U.S. government had been sending conciliatory signals to Sukarno with promises of U.S./I.M.F. aid and Sukarno had been responding favourably to these initiatives, much to the consternation of the Communist Party. "President Kennedy took a lot of trouble to persuade the oil majors to meet us halfway."[145] But the U.S. government clarified that its interests did not coincide with those of the oil companies. In his book, Defending the National Interest, Krasner argues that the interests of transnational corporations and their home governments do not always coincide. The state is not a passive actor acting on behalf of its corporate citizens. It has its own interests.

In consultation with U.S. President Kennedy, whom Sukarno respected, a presidential mission was assembled headed by a prominent Democrat, Wilson Wyatt, to request the Indonesian President to reconsider his ultimatum. The delegation included the New York consultant, Walter J. Levy, who had expended much of his life's energy repudiating the "irrational" demands of economic nationalists in several oil producing countries.[146] Wyatt was cautioned:

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[144] Penrose, The Growth of Firms, 155.

[145] Former high-ranking government official, interview by author, Jakarta, 15 January 1987.

> You should remember at all times that the United States' national interest is your paramount consideration and is not in all respects identical with the business interests of the oil companies...You should not negotiate or appear to negotiate on behalf of the American companies... The national interest is so deeply involved in the present negotiating impasse that you should regard it your responsibility to advise the American oil companies if necessary to give consideration to such accommodation as you, after examination of all the facts, regard as necessary for achievement of agreement.[147]

The ultimatum ended in the Tokyo agreement which laid the foundations for the (COW) Contract of Work. Sukarno appraised a preliminary agreement, called the "heads of agreement" on June 1 which was signed by Saleh and senior executives of Standard Oil California, Texaco, Standard of New Jersey, Socony-Mobil, and Royal/Dutch Shell. This was the first time that the oil companies had signed an agreement with the government before its deadline had expired. Before that, as it has been seen, the oil companies had called the government's bluff on several occasions. And in the preceding five years they had sought just such an outcome.

The contract of work recognised the state's legal ownership over its natural resources. It had the legal sanction of a law and was ratified by the Indonesian parliament. The oil majors would operate their previous concession as contractors to the state oil companies. The government achieved a 60/40 split. The government could obtain steady annual revenues by taking the equivalent of 20 percent of gross production in cash or kind.[148] Royal Dutch/ Shell and Stanvac would sell their domestic facilities and refineries to the state. The government did receive in kind crude from the oil companies at subsidised rates to feed its refineries. As a result, "in 1963, the three state oil companies were given a mandate to establish a proper distribution policy and to determine our whole requirement, the available product yields, and the required contribution from each company."[149]

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[146] For a Walter Levy caricature see Larry Pratt, The Tar Sands: Syncrude and the Politics of Oil (Edmonton: Hurtig Publishers, 1976), 69-71.

[147] Letter from Acting Secretary of State George W. Ball to Wilson Wyatt 24 May 1963 cited in Aden, Oil and Politics, 234.

The companies would Indonesianise the oil industry, submit work programs, and subsidise the domestic market. The transnationals only gained title to the oil for exports when the state allowed the oil to pass into their hands. "All equipment was owned by the state as soon as it entered Indonesian territory. As contractors to the state, the oil companies could 'only use it'."[150]

Saleh publicly asserted that the government had achieved "ninety percent" of what it had set out to accomplish but the Indonesian government's gains in and of themselves were not as remarkable as some observers have proclaimed. As Tirto Utomo noted, the contract of work was indeed "... a cover up or a quasi-concession. It was a concession in a different uniform because the oil majors merely paid the government on the basis of realised prices for which the government issued tax receipts and the government's participation in the oil industry did not increase significantly."[151] No tax law governed the procedures for depreciation and the deduction of costs based on generally accepted accounting principles "since the contract-of-work had been ratified by parliament."[152] As one oil company executive explains, "The revenue was to be shared on a 60/40 basis but because the Indonesian government paid the contractor's Indonesian taxes the Indonesian government's share of profits declined. Therefore, it is necessary to separate tax payments from actual profits. ... Under the COW we began to negotiate prices with the government but we did not want a government set price because price-setting was bad for tax credits. Fluctuations in prices allowed the companies greater leverage in offsetting losses."[153]

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[148] Vice-President Finance, major oil company, interview by author, 11 May 1987.

[149] Former high-ranking government lawyer, interview by author, Jakarta, 30 January 1987.

[150] Ibnu Sutowo, former President-Director Pertamina, interview by author, Jakarta, 15 January 1987.

[151] Tirto Utomo, former head of Pertamina's Legal Division, interview by author, Jakarta, Jakarta, 30 January 1987.

Since the companies sold the oil and split the profit on a 60/40 basis after deducting costs, the in-kind provision was not operationalised. The government did not have rights to obtain geological information from the companies. The state had been unable to limit the companies cost deductions. It could not prevent the oil companies from intra-firm trade. Some of these disputes would be resolved in the next bargaining encounter within the historical-structural constraints of Suharto's New Order. Others would not become part of the bargaining agenda.

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[152] Vice-President Finance, major oil company, interview by author, 11 May 1987.
[153] Ibid.

Chapter 4

Cooperative Structures and the Uses of Competition

This chapter demonstrates that the New Order state that emerged in the 1965-1967 period was more dependent on its external allies than it was autonomous at this stage of its history. But the Indonesian state had also begun to create the institutional structure to challenge the transnationals under the Old Order, a trend that was reinforced under the New Order. This structure, combined with a strong constituency within the state apparatus seeking to control the transnationals to the greatest extent possible, gave the state the ability to drive a harder bargain with the oil transnationals. International factors aided this process.

The first section demonstrates how a bureaucratic-authoritarian regime came to be established. It describes the nature of the alliance that was forged, and the constraints that it created for the Indonesian state. Section II details the emergence of state enterprises - the institutional structures necessary to challenge the transnational corporations. In section three, I discuss the major features of the production-sharing contract that would be institutionalised after a battle within the state apparatus about its utility was over. This is the subject of section four which also provides evidence of fragmentation within the state apparatus, an attempt by the oil majors to capture a section of the state apparatus, and the manner in which Suharto achieved a consensus among the senior members of the alliance without jeopardising the New Order's long-term accumulation goals. The final section demonstrates how the state utilised competition to drive a harder bargain with transnationals.

Section I

The Foundations of the Bureaucratic-Authoritarian Regime

In October 1965, a major-general of the army's strategic reserve - KOSTRAD, Suharto, crushed an obscure coup attempt that is officially attributed to Indonesia's Communist Party. Suharto did not have dashing or aristocratic origins. The son of a modest hamlet functionary in Solo, he there obtained his scholastic training in a private secondary school. In the summer of 1942 he was a mere non-commissioned officer; and a company commander in the Japanese auxiliary force, PETA, in August 1945. He won his laurels and rose through the ranks in the revolutionary war to become a lieutenant colonel by 1950. It was as the first commander of KOSTRAD that he defeated the September 30 movement, dismantled the Communist Party and proceeded to establish a bureaucratic-authoritarian regime in alliance with foreign capital, western governments and international financial institutions. In March 1968 he was formally given the presidential mandate by the MPRS.

This section discusses the nature of the Indonesian state, and the bureaucratic-authoritarian regime. Such a regime was essential to fulfill the interests of the alliance members - foreign capital, the military, and the technocrats. A bureaucratic-authoritarian regime is a variety of military authoritarianism characterised by a self-avowedly technocratic, bureaucratic, non-personalistic approach to policy making and problem solving.[1] The military regime professes to bring order and stability and modernise the economy with the aid of technocratic economic advisors, foreign aid, and investment. To this end it pursues repressive, anti-populist and exclusionary policies.

Based on his analysis of late nineteenth century Russia Gerschenkron argued that the state would play a much more active and dominant role in the late industrialisers.[2] In The Social Origins of Democracy and Dictatorship, Barrington Moore noted that in countries where there is a weak bourgeoisie and the old landed classes are still strong, capitalism tends to grow under fascism.[3] Comparing the German-Japanese developmental models and the late Latin American developers, Hirschman argued that in the latter the curve was "backward-bending".[4] Lateness had produced erratic growth and spotty government control and thus a strong state and late industrialisation were linked.[5]

Linking Hirschman's observations to an analysis of Argentina and Brazil, O'Donnell noted an "elective affinity" between industrial deepening and a bureaucratic-authoritarian regime in Brazil and Argentina. Bureaucratic-authoritarian regimes, characterised by political exclusion and centralisation, were a reaction to a structural economic crisis - the realisation of industrial "deepening" in countries where populist regimes had completed the easy phase of import-substitution industrialisation but had failed to achieve "deepening."[6]

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[1] David Collier, ed., The New Authoritarianism in Latin America (Princeton: Princeton University Press, 1979).

[2] A. Gerschenkron, Economic Backwardness in Historical Perspective (Cambridge, Mass: Balknap Press, 1962).

[3] Barrington Moore, Social Origins of Dictatorship and Democracy (Boston: Beacon Press, 1972).

[4] Albert Hirschman, "The Political Economy of Import-Substituting Industrialisation in Latin America," in A Bias For Hope (New Haven, Conn.: Yale University Press, 1971) 85-103, cited in Peter Gourevitch, "The Second Image Reversed: The International Sources of Domestic Politics," International Organization 32 (Autumn 1978), 887.

[5] See James R. Kurth, "Industrial Change and Political Change: A European Perspective," in The New Authoritarianism in Latin America ed. David Collier (Princeton: Princeton University Press, 1979), 322-323.

Peter Evans re-affirmed this view.[7] Kurth emphasised that unlike the early industrialisers, the late industrialisers required a strong state because of the high capital investment requirements for consumer, intermediate, and capital goods.[8] In 1968 Samuel P. Huntington praised the Republic of Korea for achieving centralised control and stability in the throes of economic and social flux.[9] These sequential theories suggest that history demands authoritarian solutions in countries that pursue dependent and delayed capitalist industrialisation. In this view political outcomes are influenced by the historical juncture at which countries are inserted into the world economy and by its structure. The level of competition and technological developments vary so that each comer encounters a different contest with revised axioms.[10]

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[6] Guillermo A. O'Donnell, Modernization and Bureaucratic-Authoritarianism in South American Politics (Berkeley: Institute for International Studies, University of California, 1973); also see Guillermo A. O'Donnell, "Reflections on the Pattern of Change in the Bureaucratic Authoritarian State," Latin American Research Review 13, no.1 (Winter 1978), 3-38; also see the articles by O'Donnell, Fernado Henrique Cardoso, Robert Kaufman, James Kurth, Albert Hirschman, and Jose Serra in The New Authoritarianism in Latin America ed. David Collier (Princeton: Princeton University Press, 1979). There are differences of opinion about whether O'Donnell saw a correspondence between bureaucratic-authoritarianism and elective affinity. Sang-Jin Han argues that in his original text O'Donnell "clearly treats the deepening as a motivational variable in terms of subjective intention and policy objectives" but that this is not quite so explicit in his translated texts. Sang-Jin Han, "Bureaucratic - Authoritarianism and Economic Development in Korea During the Yushin Period: A Re-examination of O'Donnell's Theory," in Dependency Issues in Korean Development: Comparative Perspectives, ed. Kyong-Dong Kim, The Institute of Social Sciences Korean Studies Series, no. 10. (Seoul: Seoul National University Press, 1987), 370-371.

[7] Peter B. Evans, Dependent Development: The Alliance of Multinational, State, and Local Capital in Brazil (Princeton, N.J.: Princeton University Press, 1979), 48; In his analysis of the Suharto government's corporatist response to interest representation King contends that delayed, dependent, and capitalist development favours an authoritarian response to modernisation. Dwight King, "Defensive Modernisation: The Structuring of Economic Interests in Indonesia," in What is Modern Indonesian Culture? ed. Gloria Davis, Southeast Asia Series, no.52 (Madison, Wisconsin: Ohio University Centre for International Studies, 1979), 185, 191-193.

[8] Kurth, "Industrial Change," 325-326.

O'Donnell's elective affinity thesis has since been empirically tested and refuted.[11] But the bureaucratic-authoritarian thesis usefully outlines the characteristics of late industrialising authoritarian regimes. Further, as Weiner notes, the intellectual debate led scholars beyond a "sterile polemic...into solid and productive research on the interaction of political and economic variables in development processes."[12]

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[9] Samuel P. Huntington, Political Order in Changing Societies (New Haven, Conn.: Yale University Press, 1968), 7, 25, 258-261. For a good discussion of praetorianism see Amos Perlmutter, The Military and Politics in Modern Times: On Professionals, Praetorians, and Revolutionary Soldiers (New Haven: Yale University Press, 1977), esp. 4-13, 89-117.

[10] Gourevitch, "The Second Image," 888.

[11] In his seminal work on bureaucratic-authoritarian regimes O'Donnell emphasised that there was an elective affinity between industrial deepening and the establishment of a bureaucratic authoritarian regime. Since then a number of scholars have criticised O'Donnell's elective affinity thesis on the grounds that BA regimes have appeared where economic deepening has not occurred. Indonesia's BA fits the latter description. It is a regime that has adopted economic orthodoxy to fulfill the preferences of the political coalitions that it represents and the requirements of the international financial institutions. It has adopted authoritarianism because populist forces opposed to laissez-faire policies were very strong in the preceding period. For criticisms of O'Donnell's thesis see Albert O. Hirschman, "The Turn to Authoritarianism in Latin America and the Search for its Economic Determinants," in The New Authoritarianism in Latin America ed. David Collier (Princeton: Princeton University Press, 1979), 79. Also see articles by Kaufman and Jose Serra in Collier volume. Also see, Karen L. Remmer and Gilbert W. Merkx, "Bureaucratic Authoritarianism Revisited," Latin American Research Review 17, no.1 (1982), 3-40; Cumings notes that Taiwan and South Korea of the mid-1960s were bureaucratic-authoritarian industrializing regimes (BAIRs). But unlike Brazil and Argentina, "the political sequence of inclusion followed by exclusion, as the "easy" phase ended and export-led development began, was absent." Bruce Cumings, "The Origins and Development of the Northeast Asian Political Economy: Industrial Sectors, Product Cycles, and Political Consequences," International Organization 38 (Winter 1984), 27. Defending himself, O'Donnell argued that the level of deactivation in the BA regime is

The emergent bureaucratic-authoritarian regime-type was partially the product of a herd mentality from the mid-1960s to the early 1970s. Although bureaucratic-authoritarianism was not causally related to a particular level of capitalist development, it grew out of the broader aim of capitalist accumulation. Where laissez-faire economic policies and order were the demands of the international financial institutions and foreign investors, bureaucratic-authoritarian regimes were the answer. In Indonesia, a bureaucratic-authoritarian regime was established in the easy phase of import-substitution industrialisation.[13]

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linked to the previous level of threat and its interaction with other historical factors. Guillermo O'Donnell, "Reply to Remmer and Merkx," Latin American Research Review 17, no.2 (1982), 45.

[12] Gabriel Almond, "The Development of Political Development," in Understanding Political Development: An Analytical Study ed. Myron Weiner and Samuel P. Huntington (Boston and Toronto: Little Brown, 1987), 465.

[13] Only two analysts of Indonesia have recognised the usefulness of the bureaucratic-authoritarian thesis to analyse the nature of Indonesian authoritarianism. While Arief Budiman recognises that Indonesian authoritarianism displays the characteristics of bureaucratic authoritarianism, he does not analyse them. see Arief Budiman, "The State and Industrialisation in Indonesia," unpublished paper n.d. Pre-occupied with the corporatist features of interest groups in Indonesia, Dwight King uncritically accepts the elective affinity between delayed, dependent capitalist and bureaucratic-authoritarianism. See Dwight King, "Indonesia's New Order as a Bureaucratic Polity; A Neopatrimonial Regime or a Bureaucratic Authoritarian Regime: What Difference Does It Make?" in Interpreting Indonesian Politics: Thirteen Contributions to the Debate, ed. Benedict Anderson and Audrey Kahin, Interim Reports Series No.62, Cornell Modern Indonesia Project, Southeast Asia Program (Ithaca, N.Y.: Cornell University Press, 1982), 104-116. Also see idem, "Defensive Modernization: The Structuring of Economic Interests in Indonesia," in What is Modern Indonesian Culture?, ed. Gloria Davis, (Ohio: Ohio University Press, 1979), 185-200.

On another note Indonesian historiographers in the modernisation theory tradition of the 1950s and 1960s have wondered why capitalism and democracy, which in their view were inextricably linked,[14] failed to develop in the Sukarno era. On the question of the failure of democracy analysts have been castigated by other Indonesian historiographers who contend that authoritarianism was natural to Indonesian political culture. In contrast to liberal democracies where democracy and capitalism are seen to be inextricably related, in Indonesia, where a multi-party system coincided with low economic growth there was a disaffection with democracy and a growing contempt for civilian government. Democracy was a Western solution. Sundhaussen asserts that the correct question to ask is: Why did democracy last so long in Indonesia?[15] In this view authoritarianism was a historical necessity in Indonesia because of internal structural characteristics which scholars attribute to the lack of a democratic tradition and its lack of legitimacy in Indonesia. But they ignore the international influences that led to the establishment of bureaucratic-authoritarianism and to the importance of capital accumulation to the regime.

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[14] See for instance George McTurnan Kahin, Nationalism and Revolution in Indonesia (Ithaca: Cornell University Press, 1952).

[15] Ulf Sundhaussen, "Comparative Analyses and the Study of Indonesian Current History and Politics," in Nineteenth and Twentieth Century Indonesia: Essays in Honour of Professor J.D. Legge, ed. David P. Chandler and M.C. Ricklefs (Clayton, Vic.: Southeast Asian Studies, Monash University, 1986), 234-35. As I have shown in chapter 2 there was an overwhelming support for collectivism in the Sukarno era. In 1959 Levi pointed out that the democratic tradition was historically absent in Southeast Asian thinking. Werner Levi, "The Fate of Democracy in South and Southeast Asia," Far Eastern Survey, 28 no.2 (February 1959), 25-29. See also Ulf Sundhaussen, Road to Power: Indonesian Military Politics 1945-1967 (Kuala Lumpur: Oxford University Press, 1982); David Reeve, Golkar of Indonesia: An Alternative to the Party System (Singapore: Oxford University Press, 1985); Harry J. Benda, in Continuity and Change in Southeast Asia: Collected Journal Articles of Harry J. Benda, Southeast Asia Studies Monograph Series no.18 (New Haven: Yale University, 1972).

The boundaries between Indonesia's state and society changed fundamentally with the advent of bureaucratic-authoritarianism. The New Order regime is best understood as the triumph of state over society through the physical annihilation of the PKI and its allies, the suppression of popular movements, and comprehensive purges of the state machinery. The state became an instrument of centralised power created apart from society.

The Making of Alliances

The army came to power with the support of several groups that were dissatisfied with the economic instability that characterised the Sukarno regime.[16] The regime used the conservative-collectivist vision described in Chapter 2 and the functional group concept to provide the intellectual efficacy for its power and which enabled it to co-opt various societal groups into the fold of the government party, Golkar, to limit challenges to its legitimacy. Suharto fashioned the presidency after Ki Dewantoro's vision of a dictator above politics. The regime also used the latent threat of the use of force, the promise of rewards and dispassionate economic policies that would bring prosperity to the average Indonesian.

It took a little over two years for the bureaucratic-authoritarian regime to be established. The first step in this process had been to destroy the Communist Party. The second step was to cement its legitimacy. During the 1950s and 1960s the army developed an ideological world-view of its position in Indonesian political life which was fundamentally different from the Western view that the military should be subordinate to civilian authority. It saw itself performing dwi-fungsi or two roles - national defense and security and a political role that it derived from seeing itself as a functional group embedded in the socio-economic and political life of the nation.

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[16] For a discussion of alliance formation see King, "What Difference Does it Make," 107. See also Martin Rudner, "The Indonesian Military and Economic Policy: The Goals and Performance of the First Five-Year Development Plan, 1969-1974," Modern Asian Studies 10, no.2 (1976), 249-284.

General Nasution, its chief architect, derived legitimacy for this perspective from the decisive role that the army had played in the guerilla war of liberation as saviour of the nation against the Dutch. In his Principles of Guerilla Warfare Nasution wrote that during the revolutionary war civilians had betrayed the nation by failing to provide political, military, psychological, and economic leadership that were essential to achieve military goals. The military equated the politics of civilians with disorder, splintered interests, and barren rhetoric. But with discipline, vision and unity, and its superior technological and military prowess, the army would provide the stability or order that development required.

The army's world-view was by no means liberal. The conservative-collectivist vision combined with its economic nationalist perspective legitimised the state's intervention in the economy. As guardians of the "national interest", the army leaders favoured economic nationalism and state intervention. Economic nationalism provided the ideological basis to give primacy to local accumulation and to bargain with the transnationals. The nationalised state enterprises of the Guided Democracy period came to be controlled by army officers. This gave them a vested interest in the perpetuation of public enterprises as sources of personal enrichment and revenue to continue the army's modernisation program.[17]

To create Gerschenkron's "coalition to win"[18] the army made trade-offs with Western governments, transnational corporations, international financial institutions, and civilian technocrats. The state's alliance with foreign and domestic capital occurred in the context of private capital accumulation.[19] The regime-type fulfilled the immediate goal of the army leadership which was to eliminate the PKI and its long-term goal which was to create favourable conditions for capital accumulation to strengthen its corporate integrity, create a repressive arm to control the state apparatus, and to further rapid industrialisation.

These trade-offs and the removal of the anti-capitalist and anti-imperialist forces, provided the low risk environment for new and entrenched foreign investors. Political exclusion and the suppression of political parties such as the PKI, favoured the interests of all the members of the new alliance. Foreign corporate interests and financial institutions were unwilling to participate in Indonesia's industrialisation programs without the guarantee that anti-capitalist forces would be curbed. The technocrats supported a liberal economic structure and the military leadership wanted to wield unchallenged sway over the political process in an economic structure which would combine capital accumulation and state intervention.

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[17] Ruth T. Mcvey, "The Post-Revolutionary Transformation of the Indonesian Army," Part 2. Indonesia no. 12 (Spring 1972), 162.

[18] Gerschenkron, Backwardness, 24.

[19] For a similar view see Nora Hamilton, "State Autonomy and Dependent Capitalism in Latin America", British Journal of Sociology 32 (September 1981), 323.

In the "so-called" Directive 6 episode, Suharto secured an alliance with the oil transnationals and the United States government. Issued in November 1965, Directive 6 demanded that the oil companies relinquish managerial control over their operations by 31 December 1965.[20] The Directive reflected one of Sukarno's last attempts to restore his legitimacy when he called for a continued struggle against entrenched neo-colonial forces, of which the transnational oil companies were perceived to be the epitome.[21]

In the two ensuing months there was a flurry of activity. The oil companies enlisted the U.S. State Department's assistance. Julius Tahija, who was soon to be rewarded with the position of managing director of all of Caltex's Indonesian operations, told U.S. Ambassador Green that Directive 6 would be tantamount to nationalisation.[22] The U.S. State Department warned Suharto that Indonesia would be unable to obtain U.S aid if it implemented Directive 6. Suspicious of the motives of Sutowo and Cheirul Saleh who had played hardball with the transnationals during the 1963 negotiations, the oil companies and the U.S. government negotiated solely with Suharto. In late November the State Department cautioned that Sutowo and Cheirul Saleh "have their own axes to grind, are presumably aware of what they are doing ...but are also principal candidates for the glory of having driven the Nekolim oil industry out of Indonesia."[23]

On 1 January 1966, Suharto responded to the threats of the U.S. government and the foreign investors. He ordered Cheirul Saleh, still Sukarno's Prime Minister, not to implement Directive 6.[24] This was Suharto's first step towards cementing an alliance with Western governments and transnational corporations, and challenging Sukarno's authority.

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[20] For a more detailed discussion of this case see Jean Bush Aden, "Oil and Politics in Indonesia, 1945 to 1980," (Ph.D. diss., Cornell University, 1988), 279-90.

[21] Sundhaussen, Road to Power, 45.

[22] Ibid., 280.

[23] Cable from Acting Secretary of State to American embassies in Jakarta and Tokyo, 23 November 1965 cited in ibid., 283.

States develop historically and therefore their historical antecedents require analysis. Each state is a social phenomenon with its own history.[25] When an emergent political elite has a tenuous base of domestic political support and when it uses repression to curb opposing political forces, then it must turn to external forces to obtain the resources and the support necessary to establish its legitimacy. Charles Tilly notes that there is a fundamental difference between the state-building process in the post-war industrialising countries and the Western European experience. In the latter, would be power-holders were primarily dependent on alliances and compromises with internal groups from which they had to extract resources to achieve centralisation and control.[26] In contrast, since Third World states obtained much of their repressive ammunition from their external allies, foreign governmments and transnationals, they could reduce their dependence on alliances and compromises with domestic forces.[27] Dominguez calls this "painless militarization."[28]

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[24] Ibid., 287.

[25] Bertrand Badie and Pierre Birnbaum, The Sociology of the State trans. by Arthur Goldhammer (Chicago and London: The University of Chicago Press, 1983), ix-x.

[26] Charles Tilly, "War Making and State Making as Organized Crime," in Bringing the State Back In ed. Peter B. Evans and Dietrich Reuschemeyer (Cambridge: Cambridge University Press, 1985), 185-6.

[27] Ibid.

[28] Jorge I. Dominguez, "Political Change: Central America, South America, and the Caribbean," in Understanding Political Development: An Analytical Study, ed. Myron

Each state creates its own war-making and coercive institutions differently. Since transnationals and their governments were in the habit of obtaining Third World resources easily, they preferred a relationship with would-be power-holders who lacked a domestic power base. This enabled these relatively unencumbered emergent elites to exchange their need for internal legitimacy while they were in the repressive phase of establishing their centralised control over civil society and for creating their war-making and coercive machineries with externally generated resources. But it is never long before specific sections of civil society seek to undermine the state's over-dependence on its external allies. Indeed, the political elite itself finds the external alliance too close for comfort. This will be demonstrated as we enter later phases of Indonesian history.

The strategies that a state will adopt and its dependency with respect to transnationals at a specific historical juncture depend on several factors. First, the general configuration of capital accumulation and the conditions its forces upon capitalist development have an impact. Second, they depend on the relative power of different classes and groups at a specific historical juncture. Third, they are influenced by the structural conditions of the international and domestic environment.[29]

But Suharto also required a minimum of domestic allies. The second step was to create an alliance with Western-oriented Indonesian neo-classical economists - the technocrats. As in General Medici's bureaucratic-authoritarian regime in Brazil and General Park Chung Hee's military junta in South Korea, technocrats were authorised

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Weiner and Samuel P. Huntington (Boston and Toronto: Little Brown, 1987), 68.

[29] Rhys Jenkins, Transnational Corporations and Industrial Transformation in Latin America (London: Macmillan, 1984), 170.

to regulate capital accumulation, wage, credit, investment, trade and monetary policies.[30] The technocratic ideology[31] is based on neo-positivist assumptions of rationality, truth, objectivity, problem-solving, and progress.[32] It advances depoliticization by excluding from its tribe all those who do not have its particular variety of information, knowledge and expertise. When expertise is legitimated as "rational, efficient, educated, progressive, modern, enlightened, what metaphors can members of other speech communities use to challenge them?"[33]

Almost all the technocrats, mockingly called the "Berkeley Mafia,"[34] whom Suharto chose to run the economy had received their education at the University of

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[30] For an excellent discussion of the Indonesian military's alliance with technocrats see Stephen Milne, "Corporatism in the ASEAN Countries." Contemporary Southeast Asia 5, no.2 (September 1983), 172-183. For O'Donnell's comments on this essential alliance see O'Donnell, Bureaucratic-Authoritarianism, 79.

[31] A growing number of social scientists have acknowledged the significance of science and technology in yielding growth, centralised socio-political decision-making structures, a dependence on technical experts, rapid economic and technological changes. These factors have produced the "knowledge" and information society where technocracies have come to dominate public policy making in "post industrial societies". see for example, Daniel Bell, "The Social Framework of the Information Society," in The Computer Age ed. Michael Dertouzoa and Joel Moses (Cambridge: M.I.T Press, 1980), 163-211. Seventy-five terms have been coined to describe technocracies. see James Bendiger, The Control Revolution: Technological and Economic Origins of the Information Society (Cambridge: Harvard University Press, 1986), 4-5. But the dominance of technocracies is not the preserve of post-industrial societies. Like many other ideas and institutions the dominant role of technocrats has been imported by many governments in the developing world.

[32] For an excellent discussion of the technocratic ideology see, Frank Fischer, Technocracy and the Politics of Expertise (Newbury Park: Sage, 1990).

[33] C.A. Bowers, "The Reproduction of Technological Consciousness: Locating the Ideological Foundations of a Radical Pedagogy," Teachers College Record 83 (Summer 1982), 531.

[34] Hamish Macdonald, Suharto's Indonesia (Blackburn, Victoria: Fontana/Collins, 1980), 76.

Indonesia's Faculty of Economics. Many of them had studied in the United States. Over the years these men would serve the IMF, World Bank and the Asian Development Bank in various capacities while holding government office. With a Ph.D from the University of California, Berkeley, Ali Wardhana, who became Finance Minister in 1968, provided the intellectual leadership for the formulation and implementation of Indonesia's "economic orthodoxy" plans.[35] The thirty-five year old Widjojo Nitisastro, who also held a Berkeley degree, and was the Dean of the Faculty of Economics, chaired Suharto's economic advisory group.

Emil Salim, a West Sumatran and grandson of the nationalist pioneer Haji Agus Salim, also had a Berkeley doctorate. Mohammad Sadli who would serve as the Minister of Mines in the most controversial period in Indonesia's oil history, had studied in the United States before obtaining his doctorate at the University of Indonesia. Rachmat Saleh who had graduated from the University of Indonesia became the Governor of the Central Bank in the New Order. Sumarlin, who would serve as Widjojo's deputy in the state planning body - BAPPENAS and later chair that body, and Subroto who would later serve as the Minister of Mines and Energy, had also received American doctorates.

For several years these young economists had served on the Staff of the Army Command and General Staff School(Seskoad) as part-time lecturers where they had first made their acquaintance with Suharto and other generation of 1945 army officers.[36] The technocrats supported a strong state that would maintain order and stability, essential to the implementation of long-term economic policy. In their view, the state was the only institution with the human resources, finances, organisation and knowledge to undertake the monumental developmental task.[37] It would stand above partisan politics. In this undertaking the technocrats saw themselves as revolutionaries or as social engineers. They had little faith in indigenous Indonesian entrepreneurs, who had performed poorly in the 1950s, and whom they had disparagingly described as feeble, chaotic, lacking capital, egocentric, avaricious and uncompetitive.[38]

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[35] He was the Indonesian governor for the IMF and the Asian Development Bank from 1962-1967. He served on the economic experts team in 1966 and became Finance Minister in 1968. He was the Chairman of the Monetary Council in 1969. And he was the Chairman of the Board of Governors of the World bank and the IMF in 1971-72. O.G. Roeder and Mahiddin Mahmud, Who's Who in Indonesia 2d ed. (Singapore: Gunung Agung, 1980), 369-70.

Lacking an independent power base, the Indonesian technocrats understood that they had "to ally themselves with the military protectors in a state coalition of technocratic brains and military brawn."[39] Their power depended upon Suharto's goodwill; their policies were subject to Suharto's veto.[40] The technocrats' power came from their legitimacy with external agencies - officials in the IMF, the World Bank, and Western governments.[41] This was an indispensable asset to the military since the regime had to implement structural adjustment programs to procure a commendatory political risk appraisal from the IMF to attract foreign investors and aid.

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[36] Macdonald, Suharto's Indonesia, 75-76.

[37] John J. Macdougall, "The Technocrats' Ideology of Modernity," in What is Modern Indonesian Culture, Gloria Davis ed., Southeast Asia Series, no.52 (Madison, Wisconsin: Ohio University Centre for International Studies, 1979), 175-6.

[38] Ibid., 182.

[39] Ibid.; for a similar interpretation see also Bruce Glassburner, "Indonesia's Economic Policy And Its Economic Implications," in Political Power and Communication in Indonesia ed. K.D. Jackson and Lucian Pye (Berkeley: University of California Press, 1978), 166-167.

[40] K.D. Thomas and J. Panglaykim, "Indonesia's Development Cabinet, Background to Current Problems and the Five Year Plan," Asian Survey 9 no.4 (April 1969), 232-3.

[41] Glassburner, "Economic Policy," 166-67.

It meant reducing the so-called political risk for foreign capital by banning strike activity, correcting balance of payments difficulties, stabilising inflation, securing the property rights of transnationals and allowing them to achieve high and relatively balanced rates of profit. Of course, the technocrats had to maintain a deferential attitude towards the paternalists and nationalists and had to accept the important role that the latter expected state enterprises to play in the economy.

A dual or triple alliance either between state enterprises and foreign capital or among the state, foreign capital, and state enterprises and/or domestic entrepreneurs has emerged in most sectors of the Indonesian economy. But the alliance is not without conflicts. And the state, state enterprises and domestic capital are not without autonomy. The shifting alliances and conflicts will be analysed in the context of the oil and textile industries.

Section II

In the literature on the state, the instrumental marxists have argued that the state's decisions merely reflect the interests of the national capitalist class.[42] Concerned with the relationship between state and civil society, these scholars did not deal with the relationship between foreign capital and the state. The regressive dependency view extrapolated the industrialising state's comprador status from the instrumentalist perspective.[43] In the instrumentalist and regressive dependency perspectives, the state has no autonomy and no interests of its own. Criticism of this view came from the realist, the structural marxist and the dynamic dependency perspectives. The structural marxist, Poulantzas, gave autonomy to the state-subject although he accorded no autonomy to his state-object.[44] The state-centric realist perspective gave the state complete autonomy. In the dynamic-dependency perspective, the state may be dependent but there is potential for autonomous action.[45]

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[42] See for instance R. Miliband, Capitalist Democracy in Britain (Oxford: Oxford University Press, 1982), 2.

Its acceptance of a dependent, although "relatively autonomous" relationship with transnationals, western governments and the international financial institutions, enabled the Indonesian state to achieve a great deal of autonomy with respect to civil society. Huge sections of society were excluded from the political process. For instance, the issue of how natural resources would be exploited and the resulting revenues used was not subject to public debate. Guided Democracy and Guided Economy had already laid the basis for centralised state control of the oil and gas industry. The province of Sumatra could not partake in the negotiations and the revenues that accrued to the Indonesian state from the rich Sumatran oil and gas fields.

The state had to accept a dependent relationship with the oil transnationals. Proven oil reserves as collateral were essential to obtain alternative sources of technology and finance from foreign governments and other corporate entities which would, in turn, enable the state to reduce its dependency on the oil transnationals in the longer term. Weinstein argues that the technocrats' acceptance of the advice of the World Bank and the IMF reduced the state's bargaining power in the exploitation of natural resources but the government gained in legitimacy with the international financial institutions and Western governments.[46]

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[43] See for instance, Andre Gunder Frank, Dependent Accumulation and Underdevelopment (New York: Monthly Review Press, 1978).

[44] Nicos Poulantzas, State, Power, and Socialism (London: New Left Books, 1980), 129.

[45] See for instance Fernando H. Cardoso and Enzo Faletto, Dependency and Development in Latin America (Berkeley: University of California Press, 1979).

Several Indonesian specialists, notably Aden, have argued that a strong state was essential for the Indonesian state to bargain effectively with the oil transnationals.[47] But the strong state/weak state demarcation is not a useful category to explain the Indonesian state's bargaining capacity with respect to transnationals. A few examples will suffice. A strong state in the 1950s would most probably have been in a position to bypass the legislation that aimed to reduce the power of the transnationals. The state might have signed more concession agreements with the oil transnationals. But it would have been unable to make much headway in enhancing its revenues because of the oil majors' dominance over international oil markets, pricing and production.

The Guided Democracy state was stronger than any previous government in independent Indonesia but it was not insulated from domestic forces. Indeed, it was penetration by domestic forces and the great political and economic outcry against the transnationals during the Guided Democracy period that enabled the Indonesian state to extract concessions from the oil transnationals.

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[46] Franklin B. Weinstein, "Multinationals Corporations and the Third World: The Case of Japan and Southeast Asia," International Organization, 30 (Summer 1976), 373-404.

[47] Aden, Oil and Politics, 512-23.

A state that is strong with respect to civil society may not be strong with respect to transnational corporations. Again, some dynamic-dependency scholars who have applied the bargaining balance of power model have criticised its explanatory value. They have argued that host governments may have the capacity to exercise greater negotiating strength with foreign investors but they may not have the political will to do so.[48] A perception of weakness may also pervade the state's decision-making agencies, preventing them from establishing regulatory controls on the transnationals' activities.[49] A perception of weakness did pervade the Indonesian state with respect to transnationals in the non-oil sectors in the early New Order years. The Indonesian state did not bargain with them. In the oil industry, to establish the bureaucratic-authoritarian regime, Suharto was forced to promise the U.S. oil companies that their contracts-of-work would not be renegotiated.

The strong state/weak state divide assumes that a strong state pursues holistic policies and is therefore in a position to make effective policies. But a state that is strong with respect to civil society may be weakened by factions within the state apparatus, as the succeeding episodes will demonstrate. In the Indonesian case, the state was strong with respect to civil society. Domestic forces external to the state apparatus were unable to influence decision-making in the early New Order years. The pressures to limit or expand the role of transnationals came from within the state apparatus. A dependency relationship with transnationals enabled the state to control and repress domestic political forces. With respect to civil society, the state was indeed monolithic. There were no opposing forces within the state apparatus that questioned the wisdom of excluding large sections of society from the political decision-making process. But the state was by no means a monolithic entity in its policies towards foreign capital, state enterprises or indigenous and Chinese capital.

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[48] Gary Gereffi, The Pharmaceutical Industry and Dependency in the Third World (Princeton: Princeton University Press, 1983), 74-5.

[49] T.H "Multinational Corporations and Dependency: A Dialogue for Dependentistas and Non-Dependentistas," International Organization 32, (Winter 1978), 79-100.

The episodes in this and the succeeding chapter show that the Indonesian state was not the executive committee of the foreign transnationals. For if it was, there would be no conflict within the state apparatus about how to deal with the transnationals. And there would be no conflict between the state and the transnationals. But there was also a convergence of interests: their joint interest in positive-sum outcomes from maximising the gains from oil exploration and production, preserving capitalism, and repressing "irresponsible" nationalism.[50]

Section III

There is general agreement in the bargaining "balance of power"/dynamic dependency literature that institutionalisation - the formation of agencies, laws, and bureaucratic structures - is a significant ingredient in the state's repertoire of bargaining resources when it negotiates with transnationals. Encarnation comments that despite the differences in opinion among the dynamic dependency and the obsolescing bargain analysts, there is agreement that "at least three sets of conditions - local institutional innovations, competition among multinationals, expansion of host markets ...(are) required to explain the behaviours of those national governments and local enterprises that had acted to dislodge multinational corporations from domestic industries."[51] State enterprises comprise key components of this institutionalised structure.[52]

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[50] Douglas C. Bennette and Kenneth E Sharpe, "The World Automobile Industry and its Implications," in Profits, Progress, and Poverty: Case Studies of International Industries in Latin America (Notre Dame: Notre Dame University, 1985), 222.

After World War II, governments around the globe established state enterprises to perform a variety of functions. These involved: enhancing the state's bargaining power with transnationals; controlling strategic industries on the "commanding heights of the economy;"[53] challenging and possibly displacing oligopolistic transnationals; pursuing joint-maximisation strategies with transnationals when they could not be replaced; maximising the state's rents by eroding the transnationals' internalised firm-specific advantages; monitoring the transnationals' activities, gaining access to information and partaking in decisions relating to technology-transfer and management fee payments, pricing of output and intra-company trade, the reinvestment and repatriation of profits and capital; creating conditions for capital accumulation by erecting the infrastructure required by transnationals; fulfilling national/social goals that transnationals found unprofitable; and conducting any other function classified as the "national interest".

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[51] Dennis Encarnation, Dislodging Multinationals: India's Strategy in Comparative Perspective (Ithaca and London: Cornell University Press, 1989), 2.

[52] See also Joseph M. Grieco, "Foreign Investment and Development: Theories and Evidence", in Investing in Development: New Roles for Private Capital? ed. Theodore H. Moran, (Washington D.C.: Overseas Development Council, 1986), 44-52; also see Richard Caves, Multinational Enterprise and Economic Analysis (Cambridge: Cambridge University Press, 1982), 261-76; Thomas J. Bierstecker, Distortion or Development? Contending Perspectives on the Multinational Corporation (Cambridge: MIT Press, 1978).

[53] Raymond Vernon, "Linking Managers with Ministers: Dilemmas of the State-Owned Enterprise," Journal of Policy Analysis and Management 4, (1984), 40.

For this, the state had to concede some of its autonomy to its state enterprises. In the Indonesian New Order's oil industry, maximising the state's rents was the state enterprises' main task. They were not expected to duplicate the transnationals' functions.[54] Foreign capital would not be ousted. While Indonesia's oil bureaucrats - lawyers, accountants and engineers - had gained much knowledge about the workings of the oil industry during the 1961-1963 contract-of-work negotiations, the base price that the transnationals could extract was still relatively high since the cost of doing without the services of the oil transnationals was too high for the Indonesian state.[55] The state remained in a dependency situation with the oil companies, dependent as it was on their three prized assets - capital, technology and markets.

The Indonesian state created the institutional structure for its participation in the oil industry and for three state enterprises in the Sukarno days. By government fiat, the state gradually eroded Royal Dutch/Shell's concession rights and repudiated the notion of contract sanctity. Moran informs us that during their moments of strength transnationals will seek to hold on to the sacrosanct nature of their contracts. But host governments will seek to erode those contracts since they are often objectively and indeed, subjectively, unjust.[56]

The Indonesian state's ability to begin this erosion, as yet largely symbolic, reflected Royal Dutch/Shell's relative powerlessness in Indonesia. Royal Dutch/Shell was damned in Indonesia, rooted as it was in the heyday of Dutch colonialism with its Dutch ancestry to boot. The company's extensive downstream facilities, spanning the archipelago, made it vastly visible. It fought a long but losing battle to survive the political onslaught on its Indonesian activities.

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[54] Former high-ranking government official, interview by author, Jakarta, 15 January 1987.

[55] Theodore H. Moran, Multinationals and the Politics of Dependence: Copper in Chile (Princeton: Princeton University Press, 1974), Chap.6.

[56] Ibid., 168-9.

In these years, the state did not pursue the joint-maximising principle with the foreign oil companies. According to this principle the rational state will not pursue strategies that undermine its long-term absolute revenues.[57] This factor in and of itself reduced Royal Dutch/Shell's bargaining power. Politically, it was more important for the state's decision-makers to nationalise Royal Dutch/Shell's assets, than to maximise its absolute revenues by pursuing cooperative relations with the company. Increased foreign investment was deterred by delays in the determination of government policy for the development of new reserves. Political instability did contribute to negative investment until the 1967 period. In estimating the extent to which total profits or rents fell below the maximum it would be necessary to take into account the loss of market share and loss of revenue. Until the late 1960s Indonesia remained a small contributor to international trade in oil - even in the Far East, whose markets came in the main to be supplied from the Middle East.[58]

In 1965 Indonesia's role as a supplier to Japan was modest. Approximately 100,000 bpd of crude oil and 10,000 bpd of refined products were reaching Japan. This constituted 25 percent of Indonesia's total oil exports but a mere 6.21 percent of Japan's daily consumption of 1, 770,000 barrels. In 1965, Caltex exported 40 percent of the Indonesian oil to Japan. This constituted 4.9 percent of Japan's daily consumption. Comparatively, Permina's oil exports to Japan constituted 0.73 percent of Japan's daily total consumption.[59] However, viewed in retrospect, the state had saved production at lower prices for future generations when the state would make significantly greater gains from oil production after 1971.[60]

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[57] Ibid., 158.

[58] Odell, Oil and World Power, 102-3.

Chief of the Army Staff General A. H. Nasution began the erosion process.[61] At the outset, it would be well to emphasise, that three state enterprises with rather similar names came to be established from 1957-1961. These were Permina, Pertamin, and Permigan. In October 1957, on the strength of Regulation No. 3 of 1956, which gave the central government control over the north Sumatran oil fields, Nasution ordered Ibnu Sutowo to create a company to explore for and produce oil and to sell its produce.[62] The dashing general, once a Stanvac medical doctor and a military officer deeply involved in the fight against the Dutch, entered the oil business with no previous experience and created the army company Permina. The company did not formally become a state-owned company until mid-1961. Sutowo's rise to power from colonel to lieutenant-general coincided with the emergence of Pertamina as a national enterprise.[63] Royal Dutch/Shell, still the legal owner of these oil fields where it had begun its first operation seventy seasons earlier, challenged Sutowo's first attempt to establish a direct sales agreement with Hutton, the owner of Refining Associates of Canada, who was willing to provide U.S. $250,000 in credits and rehabilitation equipment in exchange for oil.[64]

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[59] Alex Hunter, "The Indonesian Oil Industry," in The Economy of Indonesia: Selected Readings ed. Bruce Glassburner (Ithaca: Cornell University Press, 1971), 305-6.

[60] For a discussion of the factors that go into public policy decisions that are based on discounting heavily for future generations as opposed to producing in the immediate future see Richard Lecomber, The Economics of Natural Resources (London and Basingstoke: The Macmillan Press, 1979), 95-105.

[61] General A. H. Nasution, former Chief of Army-Staff, interview by author, Jakarta, 12 March 1987.

[62] Anderson B.Bartlett III, R.J. Barton, J.C. Bashlett, G.A. Fowler, Jr., and C.F. Hays Pertamina: Indonesian National Oil (Jakarta: Amerasian, 1972), 178.

Now the state took measures to deprive Royal Dutch/Shell of its ownership in the resources.[65] On the advice of a prominent former army attorney, S.H. Basaruddin and with Prime Minister Djuanda's consent, General Nasution revoked the concessions under the State of War and Siege the Ordinance of the Military Authority No. Prt/P.M./017/1957.[66] Responding to the British Embassy's tepid compensation demands on Royal Dutch/Shell's behalf and the ensuing queries from Indonesia's Foreign Office, Basaruddin defended the general's position. He argued that the Emergency and Siege Law had precedence over the ordinary legal status of the concession contract; the Dutch had deserted the northern Sumatran oil fields in 1942; they had never been repossessed by the Dutch or by Royal Dutch/Shell; and local workers had managed them since independence.[67]

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[63] Nasution also appointed Ibnu as the deputy-operations officer and chief administrative officer for War Administration, created to administer martial law in 1957. Ibid.

[64] Ibid., 179; Ibnu Sutowo, former President-Director Pertamina, interview by author, Jakarta, 15 January 1987.

[65] Bartlett, Pertamina, 142.

[66] Ibid., 144.

This weakened the transnational despite its strength as an oligopolist in international oil markets. Royal Dutch/Shell's bargaining power was an at ebb despite its fairly large contributions to the Indonesian treasury. The company had no choice. It had sunk investments. It did not wish to threaten its overall operations, by getting involved in an acrimonious debate over a small, war-damaged producing area where worker unrest had heightened its political risk calculations. But on the principle of contract sanctity, it had to accept defeat.

General Nasution suffered little compunction when he cancelled Royal Dutch/Shell's North Sumatran concession.[68] It was becoming increasingly clear that foreign investors would have to reckon with and at times, be at the losing end with their host governments. The instruments of sovereign state power and the expertise to match them had become more potent. The host government was climbing the learning curve.

Sutowo's next step was to rehabilitate the war-damaged oil facilities. Ibnu recognised the need for equipment, materials, and personnel training from the foreign oil companies. But he was also bent upon beginning a new phase in the Indonesian state's relationships with transnationals. He wanted them to acknowledge the national company's right to manage its corporate activities and to begin the process of un-bundling the transnationals' firm-specific assets. Prime Minister Djuanda approached Stanvac with a proposal to provide Permina with technical assistance while relinquishing managerial control to Sutowo.[69]

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[67] Ibid., 145.

[68] General A. H. Nasution, former Chief of Army-Staff, interview by author, Jakarta, 12 March 1987.

Stanvac's response was a development programme for Permina under its managerial scrutiny. It was unwilling to relinquish management but so was Sutowo. Royal Dutch/Shell and Stanvac sought to thwart Sutowo with the U.S. State Department's support. For now Stanvac's managers, whose perceptions of host government capabilities bordered on contempt, did not feel the need to concede to an erosion of its vertically-integrated turf because of the immense power that it wielded in international oil markets.[70]

Stanvac and Royal Dutch/Shell, although they were competitors, preferred to cooperate to maintain their oligopolistic control and pre-empt their rivals - state firms and independent refiners - from entering the fray. Although they were not a formal cartel, the Seven Sisters had close horizontal and vertical linkages. This gave each Sister substantial information about the activities of the other six and it encouraged some cooperation with regard to their upstream operations. They had interlocking partnerships around the globe, of which Indonesia's Caltex and Stanvac were representative examples. If Stanvac gained control over some of Royal Dutch/Shell's operations in Indonesia, Royal Dutch/Shell could expect to obtain a similar favour from Stanvac in another producing country more favourably disposed to it. But for Royal Dutch/Shell it was unthinkable to allow a fledgling state oil company to take over and to manage its concession area.

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[69] High-ranking government official, interview by author, Jakarta, 2 January 1987.

[70] Former high-ranking government lawyer, interview by author, Jakarta, 23 January 1987; Vice-president Finance, major oil company, interview by author, Jakarta, 23 February 1987.

Host states will resist such actions and seek alternative sources of capital. Sutowo turned to Japanese private and public sources for financial assistance. The Japanese government, for reasons that will later be discussed in this chapter, sought to reduce the oil majors' oligopolistic control over its oil supplies with the same seriousness of purpose as the Indonesian government, which sought to reduce the transnationals' control over the production and pricing of its oil. In mid-1958, several Japan-based companies - Bridgestone Tire, Japan Kinoshita Trading Company, and Maruzen Oil - expressed interest in buying Permina's oil. A September 1959 agreement with the Kobayashi group brought Permina $52.8 million in supply credits to obtain drilling and production equipment. This began the process of Indonesia's access to oil-for-money from Japanese private corporations and public agencies. The North Sumatra Oil Development Company (Nosodeco) was incorporated to administer the credits and to receive 40 percent of annual oil production as repayment for the credits. Since Permina only actually produced that much oil when the deal was signed, it was an extremely favourable one. Permina got managerial control; Nosodeco's role was limited to technical assistance. Nosodeco received no guarantees that the credits would be repaid.[71]

In mid-1961 Cheirul Saleh created P.N. Pertamin. It was a successor to NIAM, renamed Permindo in 1959. In partnership with Royal Dutch/Shell, the Indonesian government had inherited a fifty percent share in NIAM (Nederlandsche Indische Aardolie Maatschaapij) which controlled the rich and prized Djambi concession in south

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[71] For the factual details of this case see Aden, Oil and Politics, 187-192.

Sumatra over which Deterding and the colonial government had fought long and hard. Royal Dutch/Shell's partnership in this concession expired on 31 December 1960.[72]

Vulnerable and hostage, Royal Dutch/Shell pleaded for a renewed partnership, which Cheirul curtly refused. Erosion was the state's prime objective.[73] Following the West Irian confrontation, Royal Dutch/Shell had replaced its Dutch executives with British managers to placate Indonesian sensibilities. Then again, when confrontation with Malaysia made Britain a prime target for anti-imperialist nationalism, it brought in American and Canadian managers. In 1959 it changed its name to Permindo and moved its headquarters from The Hague to Jakarta. But the anti-imperialist tide was too strong. Despite the dissolution of Permindo, Royal Dutch/Shell agreed to provide technical assistance and access to its marketing and refining facilities.[74] The oil company was dispensable. For the first time, Royal Dutch/Shell came to terms with erosion - it accepted the un-bundling of its firm-specific assets when it agreed to relinquish management and control to Pertamin.

In the early 1960s, Pertamin was the richest state-owned oil enterprise. Although its production trailed far behind that of the majors, in 1959 Permindo had produced 8.2 percent of total Indonesian production. Permindo's assets, worth Rp 50 million, were far more valuable than Permina's debilitated facilities.[75]

The third state enterprise set up by Saleh in mid-1961 was P.N. Permigan. It was given charge of the Cepu oil wells. Cepu and Permigan were both PKI strongholds. Unable to resist worker defiance and unrest, Royal Dutch/Shell gradually relinquished its central Javan Cepu oilfields to Permigan.[76]

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[72] Bartlett, Pertamina, 182.
[73] High-ranking government official, interview by author, Jakarta, 2 January 1987.
[74] For factual details see Aden, Oil and Politics, 212.
[75] Ibid., 185.

The role of the state enterprises had also been expanded with the implementation of the contract-of-work and the 1960 Oil Law requiring the oil companies to transfer their domestic refining and sales networks to the state. Each transnational was matched with a state firm - Caltex with Pertamin, Stanvac with Permina, and the smallest producer, Royal Dutch/Shell with Permigan, the state company dominated by militant unions. Each transnational oil company paid taxes to its state-owned counterpart. The government, in turn, obtained its revenues from the state-owned companies.[77]

Saleh divided the tasks between the three oil companies. Pertamin was responsible for domestic marketing with the authority to receive the revenues for the pro-rata oil for domestic consumption; Permina was to establish a domestic oil tanker and supply fleet. Permigan was to construct new refineries. In August 1964, Deputy Prime Minister Cheirul Saleh appointed Saleh Siregar, an economics graduate from the University of Indonesia and Pertamin's finance director, as President Director of Pertamin. Within the space of a year, Siregar had acquired control of every distribution installation in the country except the air fuel facilities at major airports. Pertamin acquired the distribution networks of Royal Dutch/Shell, Stanvac, and Caltex for US$ 8 million, US$ 4.5 million and US$ 300,000 respectively.[78]

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[76] Aden, Oil and Politics, 212.

[77] Former high-ranking government lawyer, interview by author, Jakarta, 6 February 1987.

Thus, the state created the institutions for its future intervention in the oil industry. This institutionalisation would enable it to move from a position of administrative weakness and an ignorance of capitalist practices to a situation of relative administrative coherence and an understanding of how transnationals organised the global system of capitalist production rather than merely endure their might. It had begun to create new structures to combat the internalised and internationalised transnational structures. The Indonesian state had come to own upstream and downstream oil assets. Now, it would have to learn how to manage those assets. The state had begun to climb the long and arduous "learning curve."

Section IV

The bargaining "balance of power model" is based on certain assumptions. Bargaining occurs between two actors, the transnationals and the host government with certain well-defined objectives. Each party has certain assets to offer the other party. Their relative power is determined by their bargaining resources. An analysis of the bargaining resources of the two parties enables the analyst to appraise the result of the negotiation. The bargaining power and objectives of the two parties change over time. One of the key elements in the relations between a transnational and a host government is that the latter seeks to erode the transnationals' firm-specific assets - its ownership, control over the operation, technology and markets whereas the latter seeks to prevent this erosion.

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[78] For a detailed factual discussion of these developments see Aden, Oil Politics, 248-51.

From the perspective of the discussion in this section there are several key questions. In what areas does the capitalist state first seek to erode the transnationals' firm-specific advantages when the extent of its dependency with respect to them is weighty? What kinds of rights does it seek to institutionalise for itself in its contractual relationships with transnationals? Is the erosion purely theoretical and merely window-dressing? Do transnationals resist this erosion and why? Does theoretical erosion have potential substance and can it be translated into actualised power at a later historical juncture?

In the remaining part of this chapter there are three parts to the discussion. First, I will discuss some of the key facets of the production-sharing contract that came to be institutionalised in early 1967 as an improvement over the previous contract-of-work. Ibnu Sutowo was the progenitor of this contract for Indonesia, although its origins can be traced to Argentina. Second, I will show how transnationals sought to exploit fragmentation within the state apparatus to achieve their objective of undermining the production-sharing contract. But with the aid of competition and the state's ability to resist the oil majors' encroachments, the production-sharing contract was instituted. Finally, I will show how the state gradually began to erode the transnationals' firm-specific assets. But there were areas in which it did not seek this because of a realisation of its limited capabilities at this specific historical juncture. In a book that is devoted to constraints, The Economic Limits to Modern Politics, David Held comments: "For an agent to fail to consider limits, except for extremely strong and specific reasons, is necessarily perverse, irresponsible, and inept. ...Nowhere is this more evident or more important than it is in the case of politics."[79]

In the mid-1960s, the Indonesian production-sharing contract symbolised a radical departure from petroleum contracts operating in other parts of the world. Soon countries such as India and the Philippines would seek to imitate it. It was the product of the post-World War II tendency of governments to intervene in regulating petroleum production and pricing, unlike the pre-war situation when private oil companies controlled rates of output and prices completely.[80]

Since every government is responsible for safeguarding its own economic interests, it will scrutinise the transnationals' activities within its territorial reach.[81] Host governments cannot presume that foreign firms will not seek to augment their consolidated profits, seek to maintain complete control over the management of their operations or differentiate among governments. International firms conduct their operations with a view to their global consolidated profits. They insist on owning their subsidiaries completely to prevent host country nationals from intervening in their decisions.[82]

In selecting the procedure for optimum rent allocation, a state has to make certain basic decisions about its investment priorities. The first is whether it wishes, or is able to share in the initial risk investment. It is within those limits that the state will seek to maximise its gains with transnationals. The Indonesian state's capacity for autonomous action was limited by international economic constraints. The austerity programs propagated by the international monetary institutions and the technocrats forced the state-owned company to adopt a rent-seeking/risk reduction approach to its participation in the oil industry,[83] which I will call the "rentier syndrome".

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[79] John Dunn, "The Economic Limits to Modern Politics," in The Economic Limits to Modern Politics ed. John Dunn (Cambridge and New York: Cambridge University Press, 1990), 4-5.

[80] Neil H. Jacoby, Multinational Oil: A Study in Industrial Dynamics (New York: Macmillan, 1974), 111.

[81] Edith T. Penrose, The Large International Firm in Developing Countries: The International Petroleum Industry (London: Allen & Unwin, 1968), 264.

[82] Ibid., 265.

This approach prevented state enterprises from seeking to replicate, in a significant manner, the transnational's complex upstream functions. But despite its commitment not to erode the transnational's productive role except in an experimental way, which contributed to its dependency relationship with the international oil firms, the Indonesian state would not be passive. Without threatening the parameters for joint-maximisation and its absolute long-term revenues, the state would seek to maximise its rents, and to challenge, monitor, and control transnationals:

> The participants in the game are opponents, but since their mutual action determines total profits and each other's absolute share of total profits (no matter what their relative shares), they have important common interests. They are not partners, for their interests do diverge in important respects. Nonetheless, they cannot ignore the possibility of mutual benefit and harm. Both company and government have strong interests in maintaining a high-level and growing level of revenue even though they cannot agree totally on the sharing of it. While each party is seeking to maximise its share, rational behaviour requires each to favour a movement towards

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[83] High-ranking government official, interview by author, Calgary, 15 September 1986; Former high-ranking government official, interview by author, Jakarta, 19 May 1987.

joint-maximisation.[84]

The production-sharing contract abandoned the traditional concession arrangement under which management and ownership rights were vested exclusively in the foreign contractors.[85] Foreign oil companies would be contractors to the state. The aim was to increase the state's involvement in the oil industry, to gain a right to market its own oil, to own the natural resources, and to limit the amount that the transnationals could deduct annually for cost recovery.[86]

The Indonesian state gained management responsibilities and title to the oil. The transnational gained gained control over the oil at the f.o.b. point of export. Although the contractor was exclusively responsible for furnishing all the foreign exchange, materials, equipment, and supplies necessary for the operation-including technical aid and foreign personnel- the contracts state that Pertamina shall have and be responsible for the management of petroleum operations. By sharing production instead of profits, Sutowo sought to underwrite a marketing role for state enterprises and to eliminate the constant bickering over prices with the transnationals. The transnational would finance the operation completely and bear all the pre-production risk and costs. Costs would be recouped from 40 percent of each barrel produced. Excess costs would be recovered in ensuing years. From the remaining 60 percent of production Sutowo demanded 65 percent of the production as revenues for the state instead of 60 percent of profit under the contract-of-work. When commercial production began, the company would contribute 25 percent of its profit oil at 20 cents a barrel for Indonesian domestic consumption.

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[84] Raymond F. Mikesell, "Conflict in Foreign Investor-Host Country Relations: A Preliminary Analysis," in Foreign Investment in the Petroleum and Mineral Industries ed. Raymond F. Mikesell (Baltimore and London: The Johns Hopkins Press, 1971), 43.

[85] This discussion is based on a perusal of various production-sharing contracts and interviews conducted from December 1986 through September 1987.

[86] High-ranking government official, interview by author, Jakarta, 2 January 1987; Former high-ranking government lawyer, interview by author, Jakarta, 6 February 1987.

Pertamina would automatically own all contract-related equipment that the oil companies brought to Indonesia for which they could recover costs from the 40 percent "cost oil". But they would pay Pertamina an annual rental of 10 percent of the costs of the equipment for ten years to cover depreciation and until the full costs of the equipment were recovered by the state. The production-sharing contractors would pay non-recoverable bonuses galore: to enter the market; when they achieved contractually specified production levels; when they wanted their relinquishment schedules deferred; to buy information from the government; and when on an individual basis they sought additional incentives that were not specified in their contracts.

Regulating the costs of the transnational is a major aim for host governments. As was discussed in chapter 3, in the 1950s, the issue of cost deduction had caused disputes between host governments and transnationals. For the Indonesian state, unlimited cost recovery had meant, that it did not obtain revenues from oil production after the transnationals had recovered their costs, profits and dividends from gross profits.

Consequently, a host government cannot leave transnationals unregulated and treat their activities like uncomplicated business arrangements.[87] Concerned as it is with maximising its revenues and reducing the "exploitative" content of a transnational's activities within its territorial borders, a better-informed government will seek to erode the transnationals' internal markets by forcing them to increase their arm's-length transactions in external markets or by making use of competition to arrive at an external measure for costs that transnationals incurred in their internal markets.[88]

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[87] Penrose, The Large International Firm, 266.

When the transnational has the final say in determining which expenses to book and the amount that will be deducted for costs, the transnational will benefit from inflating costs through transfer pricing, intra-firm trade, and intra-firm service exchanges.[89] Concerned with maximising their global profitability, transnationals will be inclined to reduce the government's profit share by inflating costs. Inflated costs enable firms to maximise their before-tax profits and to increase their overall profitability even if their after-tax profits are lower.[90] The Chief Executive Officer of an oil major explained:

> We do not deliberately show higher operating costs but we do conduct a large part of our business through intra-firm trade and intra-firm service arrangements. Consequently a large number of our transactions are internalised and costs are deducted accordingly. We try to keep most of our transactions within the family.[91]

The ceiling on cost deduction would secure at least 39 percent of the revenue from each barrel of oil as revenues for the state.[92] Expected to have enough equity to finance their operations, the oil companies would not deduct interest payments for monies borrowed from their parents and sister affiliates. Finance is, after all, one of the firm-specific advantages for which transnationals extract benefits from host governments.

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[88] Moran, Politics of Dependence, Chap 6.

[89] Penrose, The Large International Firm, 265-6.

[90] Ibid., 265.

[91] Chairman, Managing Board, major oil company, interview by author, Jakarta, 18 January 1987.

[92] Ibnu Sutowo, former President-Director Pertamina, interview by author, Jakarta, 15 January 1987.

Sutowo created marketing rights for the state to gain a window on the price that Indonesian crude would fetch in arm's length transactions to maximise its revenues by minimising transfer pricing by the international firms. From Sutowo's perspective, this issue had been acrimoniously but unsuccessfully debated during the 1961-1963 negotiations. Pertamina would market its own share of production and the oil for cost recovery if it could surpass the price that the transnationals firm obtained in its internal, integrated circuits.40

The state had ownership rights in the mineral, "the basic raw material, which is a wasting asset - the extraction of the oil permanently reducing the resources of the country."[93] Through ownership Sutowo sought to extract certain benefits from the oil companies. The state derived ownership over all the tangible capital assets that the company brought to or used on Indonesian territory. Sutowo sought information about the company's operations, the geological research and development that was relevant to the mineral assets that the firm was exploring and developing, the costs that it incurred to develop the mineral resource and the price at which the company sold the resource when it began production.

This is where the interests of the state and the transnationals differ. Most scholars whether they are of the dynamic dependency, regressive dependency, industrial organisation or orthodox liberal persuasion, agree that transnationals closely safeguard technology, their firm-specific advantage.[94] If the transnational gives the state, which is also its potential rival, easy access to technology, the transnational runs the risk of underming its long-term presence in the host country. The state's interest is to erode the transnational's monopoly over technology so that some or all the transnationals' activities can eventually be replaced.[95]

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[93] E. T. Penrose, The Growth of Firms, Middle East Oil and Other Essays (London: Frank Cass, 1971), 153.

All technical information, maps and surveys would become state property when the companies withdrew. The transnationals would conduct their work programs, their investments, and their exploration and development programs according to a government-stipulated schedule. The oil companies would inform the state oil company of their strategic decisions regarding their oil operations in monthly written reports and consult with state managers on a monthly basis when commercial production commenced. The oil companies would relinquish certain percentages of their acreage after specified intervals if they failed to discover oil; spend specified amounts of money to accelerate oil discovery; and pay signature bonuses for relinquishment schedule postponements. An Indonesian government lawyer described relinquishment as a "security" issue that brought commercial benefits to the state.[96]

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[94] See Richard S. Newfarmer, "International Industrial Organization and Development: A Survey," in Profits, Progress and Poverty: Case Studies of International Industries in Latin America ed. Richard S. Newfarmer, (Notre Dame: Notre Dame University, 1985), 13-62; Richard Newfarmer and W. Mueller, Multinationals Corporations in Brazil and Mexico: Structural Sources of Economic and Non-Economic Power, Report to the Subcommittee of Multinational Corporations of the Committee on Foreign Relations, United States Senate, Washington DC, US Government Printing Office, 1975; Tamir Agmon and Seev Hirsch, "Multinational Corporations and the Developing Economies: Potential Gains in a World of Imperfect Markets and Uncertainty," Oxford Bulletin of Economics and Statistics Special Issue, The Multinational Corporation 41, no.4 (November 1979), 333-344; Raymond Vernon, Storm Over Multinationals: the Real Issues (London: The Macmillan Press, 1977), 40; for a conventional internalization view see Mark C. Casson, "Transaction Costs and the Theory of the Multinational Enterprise," in New Theories of the Multinational Enterprise ed. Alan M. Rugman, (London and Canberra: Croom Helm, 1982), 24-43. Also see Alan M. Rugman, Inside the Multinationals: the Economics of Internal Markets (London, Croom Helm and New York: Columbia University Press, 1981).

[95] For a discussion of how local firms and host states increase their bargaining power in technology along the lines of the "bilateral monopoly" model see Farok J. Contractor, International Technology: Licensing, Compensation, Costs and Negotiations (Lexington, Mass: Lexington Books, 1981); also see Agmon and Hirsch who comment on the long-term tendency of the state and local firms to enhance their bargaining power, Agmon and Hirsch, "Multinational Corporations and Developing Economies."

General petroleum laws in the post-war period have traditionally established ceilings on the size of concessions which were much smaller than their pre-war counterparts.[97] The result was to multiply the number of firms holding concessions and to increase the competitive pressures to find and produce oil. Relinquishment aimed to involve a large number of firms in developing the host country's oil resources rapidly, hastening revenue flows. Relinquishment brings several benefits to the state. Firms cannot hold host states hostage for long periods. Host states can force firms to pursue active work programs. If they fail, other companies can be invited to use different or more sophisticated geological techniques to improve the probability of finding oil.[98]

Relinquishment enables the state to erode the firm's knowledge-based assets and gives the state a better idea of its geological terrain and access to added rents. Geological information enables state decision-makers to determine whether a particular area is promising, how to assess future bids, and what additional advantages to extract from the foreigner. The state can begin to erode the transnational's monopolistic control over information, de-mystify itself, and in the long term, develop the capacity to bargain with the transnationals from a position of knowledge rather than ignorance. It can determine how vulnerable it must truly be to the transnational corporation instead of calculating its bargaining resources on the basis of perceived weaknesses.

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[96] High-ranking government lawyer, interview by author, 8 February 1987.

[97] Jacoby, Multinational Oil, 112.

[98] Ibid.

Section V

Transnationals tend to exploit the internal divisions within the state. Different sections of the state apparatus are often captured by segments of the capitalist class. "Those groups seeking to expand the role of the state are checked not only by domestic and foreign capital but also by factions within the state which identify with the needs of private capital."[99] From the late 1960s to the mid-1970s, the oil transnationals exploited the internal divisions within the state apparatus to prevent the erosion of their share of profits with respect to the Indonesian government. Transnationals take stock of the different ideological perspectives represented in the state apparatus to form alliances with those groups that will best serve their interests. But the transnationals were only partially successful in this endeavour. Suharto tended to support those decision-makers in the state apparatus, who sought to enhance the state's revenues through forceful bargaining with the transnationals. But Suharto also tended to undermine those state decision-makers whose actions threatened capital accumulation, that is, those sections that pushed the transnationals to the point where joint-maximisation strategies and the state's absolute revenues were threatened.

In this interlude, the technocrats and the incumbent oil majors formed an alliance.

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[99] Peter Evans, Dependent Development, 216.

This became evident in the internal battle within the state about the new contractual arrangements to be granted to the oil companies. It was a battle between Sutowo, a staunch economic nationalist, who had little respect for civilians and contempt for neo-classical economists, and Bratanata, the technocratic oil minister who returned those sentiments with equal fervour for army officers who sought to monopolise the state's revenues. The outcome of this battle was a compromise deal to satisfy the demands of the oil majors, Ibnu Sutowo and the technocrats. Sutowo was allowed to implement the production-sharing contracts freely. Yet Suharto was also not willing to undermine the state's alliance with the incumbent oil majors by reneging on their newly negotiated contracts-of-work.

Although the military had undisputed control in maintaining order, the new balance of power regarding economic policy making, and particularly oil policy, was still unclear. The two fractions in the state apparatus, represented by the economic nationalists and the technocrats, were willing to forge alliances with different sections of foreign capital to keep their opponents in the state apparatus at bay. Oil was particularly important, for it was the group within the state apparatus that controlled oil money that would determine its development priorities.

Dynamic dependency and balance of power bargaining scholars emphasise that administrative coherence is a fundamental requirement for the state to increase its bargaining power with transnationals. Administrative weakness, on the other hand, is seen to interfere with the state's ability to achieve favourable outcomes in its bargaining encounters with transnationals.[100] The relative power of the ministries and agencies involved in the formulation and implementation of policy, and the relationships among them, affect the state's ability to carry out its policies. Bureaucratic conflict within the state not only makes unified action more difficult but also allows corporations to play off one state agency against the other.[101]

The administrative weakness of Third World states can be generated from internal causes - the lack of political will, ignorance, or carelessness as well as from external structural dependencies such as the power of transnationals. Lack of financial resources is also an internal feature of weakness and so is the lack of an entrepreneurial class. The battle between the two sets of government opponents, the technocrats and the economic nationalists in Indonesia, illuminates some of these weaknesses.

Sutowo was a staunch economic nationalist. Any leader who had become involved in oil decision-making in the early 1950s and 1960s and who had watched OPEC's deliberations with the oil companies could helplessly grasp the immense power that the international oil companies exercised and the massive profits that they enjoyed. It should come as no surprise that host states will seek to maximise their gains from a rich natural resource industry when their development plans can only be met with rents from it.[102] Sutowo was no different. In a 1967 speech he would refer to the "imperialist cunning" of the international oil companies and their desire to replace nationalist regimes with puppet governments. He also distinguished his economic nationalism from the variety espoused by the PKI which he decried as unilateral and arbitrary, seeking to nationalise the international oil companies and to alienate Western countries.[103]

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[100] Douglas Bennette and Kenneth Sharpe, Transnational Corporations Versus the State: The Political Economy of the Mexican Auto Industry (Princeton: Princeton University Press, 1985), 86; Moran, Politics of Dependence, Chap.6.

[101] Ibid.

[102] Vernon argues that even when the state bargains and extracts greater rents, its revenue needs also expand. So there is always a sense of urgency to re-negotiate the original bargain. Vernon, Sovereignty at Bay.

Sutowo's interest in the production-sharing contracts had internal and external ramifications. Internally, with Suharto's consent, Sutowo aimed to raise finances for the army, Suharto and for Pertamina so that the economic nationalist goals could be achieved. Externally, with respect to the transnationals, Sutowo aimed to erode their control over Indonesia's oil industry.

It is common for Indonesian analysts to discuss Indonesian economic policy as a rivalry between the technocrats and the economic nationalists, as if Suharto was a neutral arbiter who made no contribution to the policy issues around which the debates between the two groups occurred.[104] This is because Suharto has chosen to adopt the public image of a charioteer, reining in his two horses - the military and the technocrats - to maintain a balance so that the chariot is not overturned. If this is his intention then he has done an excellent job of it. But economic nationalism was part of the military's repertoire, and Suharto was no less an economic nationalist than Sutowo.

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[103] Wayne Robinson attributes Sutowo's distinction between his variety of nationalism and that of the PKI as an attempt to ensure his political survival in the New Order regime. Wayne Robinson, "Imperialism, Dependency and Peripheral Industrialization: the Case Of Indonesia," in Southeast Asia: Essays in the Political Economy of Structural Change ed. R.A. Higgot, and R. Robison, (London: Routledge, 1985), 200. The point that Robinson misses is that even the most right-wing regimes have sought to enhance their benefits from the operations of transnationals, and in the context of this discussion, from the oil industry.

[104] See for instance Richard Robison, Indonesia: Rise of Capital (North Sydney, Australia: Allen & Unwin, 1986); Aden, Oil and Politics.

Sutowo and Suharto articulated the army's position on industrialisation. They did not abandon Sukarno's goals of self-sufficiency, aspirations of great power status within the Asean region, or the non-aligned ethos that denounced a dependency relationship on external forces - be they former imperialist powers or transnational corporations. Weinstein alludes to the strong anti-imperialist ethos that colours the thinking of many political elites in Indonesia. The industrial paths followed by Britain and the U.S.A. provided ample proof of how great power status could be achieved.

As the bargaining "balance of power" analysts, Moran, Penrose, Vernon, and Mikesell have demonstrated, state decision-makers do not have to be socialist to be anti-imperialists or economic nationalists. Indeed, anti-imperialism had become a part of the Third World ethos.[105] Further, the state is constrained by its commitments to its alliance members. Suharto would not relinquish the goals of self-propelling industrialisation which involved: establishing infrastructure, heavy industries, training personnel, and above all, promoting a resilient national entrepreneurial class. Nor could he. He could not incur the wrath of the economic nationalist faction in the army. There was a strong constituency for this view in OPSUS, the political and intelligence centre led by General Ali Murtopo and General Soedjono Hoemardani.

The economic nationalists firmly believed that state intervention was essential to create a national industrial economy. The economic nationalist view was enunciated by the intellectuals affiliated with the Centre for Strategic and International Studies, of whom Jusuf Panglaykim, a Chinese academic and businessman, was the most celebrated. He denounced the exploitative and destructive character of foreign investment for Indonesia's long-term development. He was Indonesia's Prebisch, passionately advocating import-substitution industrialisation and an economic structure in which the state controlled finance and production to achieve national goals.[106]

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[105] Penrose, The Growth of Firms; Moran, Politics of Dependence; Mikesell, Foreign Investment; Vernon, Sovereignty at Bay.

But the state in a dependency situation must make certain compromises to appease its external and domestic allies. With the Improved Dwikora cabinet re-shuffle on 25 July 1966, Sutowo was replaced as Minister of Mines by Ir. Slamet Bratanata, a principled, thirty-eight year old Dutch-educated engineer. Ibnu remained Director General of Migas and President-Director of Permina. Sutowo was an unpopular choice for Suharto in those early years, since Ibnu's diversion of oil money to serve specific army interests had made him a controversial figure.[107] He had none of the qualifications to appease the technocrats and the international financial institutions. He had demonstrated little fiscal responsibility in the use of oil monies and he was an economic nationalist who seemed bent upon undermining the position of the incumbent oil majors.

Hiring a technocrat to the important cabinet position of Minister of Mines was one strategy pursued by the New Order regime to provide a civilian face to a predominantly military government, to persuade Western governments and international financial institutions that it would pursue an earnest policy of fiscal restraint and create favourable conditions for the oil transnationals. Bratanata was also acceptable to liberal army leaders. Bratanata had an enduring bond with West Java's Siliwangi Division, commanded by General Nasution in the late 1940s. Siliwangi played an instrumental role in managing state-enterprises during Guided Democracy and it would sponsor the famed August 1966 seminar which established the neo-classical tenets of economic reform for the New Order regime.[108] But Bratanata was unacceptable to the economic nationalists.[109] Bratanata sardonically confesses, "Hoemardhani could not stand me."[110]

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[106] For a detailed discussion of economic nationalism in the 1965-1974 period see Robison, Rise of Capital, Chapter 5.

[107] Interview Slamet Bratanata, former Minister of Mines, interview by author, 25 March 1987.

According to the conventional theory of foreign investment, based on neo-classical economic theory, private firms seek to optimise their earnings by investing money where they can obtain the best marginal return on investment.[111] Drawing upon this perspective, Bratanata believed that the state's interests would be best served if foreign investors had a risk-free, unencumbered investment climate. In his view, the supply price that should be paid to the oil transnationals had to be as low as it had been when the government had negotiated the contracts-of-work. The Indonesian state did indeed apply this philosophy to the general manufacturing industries, beginning in 1967, as I will show in my later discussion of the textile industry. In his first speech to parliament Bratanata stated that his immediate goal was a 10 percent increase in oil revenues. "We had to create a positive climate for foreign capital if we wanted to achieve this goal."[112]

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[108] Franklin B. Weinstein, Indonesian Foreign Policy and the Dilemma of Dependence: From Sukarno to Soeharto (Ithaca and London: Cornell University Press, 1976), 232.

[109] High-ranking government lawyer, interview by author, Jakarta, 14 January 1987.

[110] Interview Slamet Bratanata, former Minister of Mines, interview by author, 25 March 1987.

[111] Moran, Politics of Dependence, 110-11.

Bratanata adamantly believed that Sutowo's confrontational demand to manage and control the oil industry would drive foreign oil companies away without bringing tangible benefits to the state.[113] Permina and Pertamin lacked experience and skills and the state required the transnationals' technical, financial and marketing services. To be fair to Bratanata, the turbulent events following Qadaffi's rise to power in 1969, which I will shortly portray, had not occurred and the gradual erosion of the oil majors' power by independents was not as yet obvious. It was only in the 1970s that the obsolescing bargain concept would be popularly understood.

The incumbent transnationals, Stanvac and Caltex, exploited the raging debate within the state apparatus about how the national interest could best be served with the aid of oil transnationals.[114] Expressing their opposition to the production-sharing contract, the oil majors propagated the conventional theory of foreign investment. They were afraid that relinquishing managerial privileges would give the Indonesian government the legal means to oust them in the long term. They were also afraid that they might be forced to make similar concessions to other oil-exporting countries.[115]

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[112] Interview Slamet Bratanata, former Minister of Mines, interview by author, 7 July 1987.

[113] Ibid.

[114] Vice-President Finance, major oil company, interview by author, Jakarta, 6 March 1987.

[115] "Most favoured nation" clauses gave the host state a right to adopt the terms adopted by any other country. If they relinquished the management clause to the Indonesian government, they would have to concede it to other oil exporting countries. H. Cattan, The Evolution of Oil Concessions in the Middle East and North Africa,

The oil majors asserted that control of the Indonesian oil industry by inexperienced state managers, whom they viewed with contempt, would be disastrous to the goals of efficiency and profitability. Risk-bearing functions, they asserted, could not be separated from managerial functions.

The oil majors affirmed that only in the shape and form of the contract-of-work would Indonesia's contractual arrangement remain attractive to foreign investors. Only six months before, in the Directive 6 saga, they had firmly declared that they would not relinquish their managerial privileges to the state. Like Bratanata, the oil majors argued that the management clause would be illusory. The transnationals were afraid of the transformation of their restricted oligopoly to a workable competition situation by the entry of rivals.[116] They were afraid that their firm-specific advantages that gave them unrivalled control over oil would be eroded.[117] Since the oil majors controlled marketing and pricing they were sufficiently confident that with concerted pressure, the support of the United States State Department, and an ally in person of the Minister of Mines himself, they would discourage Suharto from allowing Sutowo to pursue his folly.

When specific fractions of the state apparatus form alliances with transnationals it does not always imply that those sections have been captured by the transnationals. Certain sections in the state apparatus may form alliances with foreign capital to further

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(Dobbs Ferry, N.Y.: Oceana, 1967), 99-100.

[116] See Vernon, Storm Over Multinationals, for his discussion about how this process occurred.

[117] For a discussion of the intangible assets that spur international firms into the internationalisation of production see Stephen Hymer, The Multinational Corporation: A Radical Approach ed. R. Cohen, N. Felton, M. Nkosi, and J. van Liere (Cambridge, Mass: Cambridge University Press, 1979).

their own interests or their own perception of what constitutes the "national interest". That is, there may be a convergence in the means that the two parties use but they may have different ends. The technocrats were willing allies of the incumbent oil companies, the oil majors, not because they were comprador but because they had interests of their own. The technocrats, Bratanata included, wanted parliament to scrutinise the oil contracts and to prevent the army from monopolising the oil industry.[118] The transfer of oil revenues to the state oil company would prevent the Ministry of Finance from controlling revenues, the Planning Ministry from setting industrial goals, and the Ministry of Mines from fulfilling its legal mandate to negotiate contracts with the transnational corporations.

Since 1957 Sutowo had provided ample proof of his desire to monopolise oil revenues and use them as he saw fit. The production-sharing contract, under which revenues would flow directly to Permina, would give him complete control over oil revenues. His move to merge the oil companies was viewed with trepidation. Bratanata supported the continued existence of two national oil companies because he believed that healthy rivalry between Pertamin and Permigan would promote efficiency. The technocrats did not buy Sutowo's rationalisations, although he had thought them through exceedingly well.

To evade parliamentary approval and to persuade the oil companies to accept a contract without government guarantees, Sutowo sought historical sustenance. He reminisced about the parliamentary bickering that had characterised Indonesian politics during the 1950s and 1960s and the inefficiencies that it had brought to the oil industry. In a later interview, Bratanata negated this argument. "Anything could have been rammed through parliament in those days."[119]

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[118] Aden has provided a detailed analysis of the rivalry between the two state oil companies - Permigan and Pertamin during the late Sukarno and the early New Order years until the eventual merger of the two companies in August 1968 bringing about Sutowo's eventual control over the oil industry. Aden, Oil and Politics, chap. 4.

Whether oil revenues were directed into a Permina account or into the state treasury mattered little to the incumbent transnationals. This was an internal power struggle. But they were willing to capitalise on this internal dispute between the technocrats and Sutowo.

From August to January Sutowo and Bratanata were involved in a battle of wills. Both men were handing out the same acreage to different oil companies under different contractual arrangements.[120] But the balance of power between the technocrats and Sutowo shifted to some extent after Suharto had consolidated his power and gained legitimacy in the eyes of Western governments and aid agencies.

Although Suharto had cemented an alliance with American oil majors and the technocrats, he was not willing to take all his cues from them. Nor could he. Economic nationalism was alive and well in Indonesia. Suharto would support the production-sharing contract. On January 19 1967, as chairperson of the Presidium Cabinet, General Suharto told Bratanata to accommodate the production-sharing contracts.[121] Permina would have direct control over the revenues from these contracts.[122]

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[119] Interview Slamet Bratanata, former Minister of Mines, interview by author, 25 March 1987.

[120] High-ranking government lawyer, interview by author, Jakarta, 12 December 1987.

[121] Bartlett, Pertamina, 297.

But at this historical juncture when the revenues from the oil industry, Western governments, and the international financial institutions were his sole source of support, Suharto could not undermine the alliance structure in which the transnationals were the senior members. Suharto kept his word to the oil majors. The sanctity of their contracts was reaffirmed. Moran argues "the formal contract with the ritual 20-40-99 year guarantee of 'inviolability' is a way of celebrating the foreign investor's moment of strength."[123] Suharto mollified the technocrats and the international financial institutions with his decision that the Ministry of Finance would control the contract-of-work revenues which constituted 90 percent of the state's revenues.[124]

Sutowo was rewarded with a tractable oil minister later that year and in the next with a merger between Pertamin and Permina. On October 11 1967, Dr. Ir. Sumantri Brodjonegoro, a man who agreed with Sutowo's production-sharing contract and with the concept of a single national oil company became Minister of Mines. The foreign investment law of 1 January 1967 gave legal sustenance to the production-sharing contract since Indonesian firms could sign any of a variety of contracts with foreign investors without parliamentary approval.[125] On 20 August 1968 Pertamin and Permina were merged.

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[122] Former high-ranking government lawyer, interview by author, Jakarta, 6 February 1987.

[123] Moran, Politics of Dependence, 169.

[124] Former high-ranking government official, interview by author, 7 July 1987.

[125] Former high-ranking government lawyer, interview by author, Jakarta, 6 February 1987.

Section VI

> In the natural resource sector the host government must actively search for an independent to play off against a major. The use of subsequent rivalry among foreign firms to re-negotiate the award of benefits granted to the first investors runs counter to the advice of international business groups that stability be the principal feature of the model investment climate. Surveys of corporate opinion have generally confused the desire for profitability in keeping with the demand for stability in the investment climate of the host country.[126]

The state's bargaining power with transnationals increases when its location-specific advantages are sufficiently attractive to entice several rival firms. Then the host state, holding the keys to entry, may extract several concessions from transnationals when they seek new acreage within its territorial borders. When one member of the club makes a move, the others pant to follow.[127] Competition gives the state the capacity to extract more favourable terms from new entrants and drive a tougher bargain with incumbent investors.[128] The state learns to play off one oligopolist against the other.[129] The host state has to provide reduced incentives to attract later entrants in natural resource industries when the geological risk and uncertainty has been reduced because the first comers have proven the existence of substantial reserves.

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[126] Moran calls this a strategy of producing oligopolistic anxiety. Theodore H. Moran, "The International Political Economy of Cuban Nickel Development," in Cuba in the World ed. Cole Blasier and Carmelo Mesa-Lago (Pittsburg, Penn.: University of Pittsburg Press, 1979), 257-272; in his study of the automobile industry Jenkins finds a similar phenomenon. see Rhys Jenkins, Dependent Industrialization in Latin America: The Automotive Industry in Argentina, Chile, and Mexico (New York: Praeger Publishers, 1977), 40-2.

[127] Frederick T. Knickerbocker, Oligopolistic Reaction and Multinational Enterprise (Boston: Harvard University School of Business Administration, 1973), 197-8.

[128] Robert Grosse, Multinationals in Latin America (London: Routledge, 1989), 74; Vernon, Sovereignty at Bay, 55: Thomas N. Gladwin and Ingo Walters, Multinationals Under Fire: Lessons in the Management of Conflict (New York: Wiley and Sons, 1980); Dennis Encarnation and Louis T. Wells, Jr. "Sovereignty En Tarde: Negotiating with Foreign Investors," International Organization, 39, no.1 (Winter 1985), 47-78.

[129] Moran, The Politics of Dependence, 160-1; Newfarmer, "International Industrial Organization," 17.

As the bargaining "balance of power" model explains, it is the initial investor who takes the risk to prove the commercial viability of a host country's geological reserves. In return, the foreign company expects the host government to write it a blank cheque. But once the bonanza is discovered, the host government will not provide such terms to new investors. Indeed, it is increasingly inclined to re-write the original terms under which the first investor had entered.[130] In the mid 1960s, Caltex's Minas constituted Indonesia's big bonanza. It was Caltex's Minas that gave Sutowo the confidence to demand better terms from foreign investors to explore and develop Indonesia's oil tracts. It was in the hopes of discovering another Minas that foreign investors came flocking to Indonesia. And it was this hope that made them accept the terms of the production-sharing contract.

Over time, new multinational investment reduces the level of concentration and barriers to entry facing potential entrants.[131] In the oil industry, independent oil companies increased the host state's options[132] and enabled them to increase their bargaining power with respect to the majors. They served as catalysts, enabling host governments to erode the oil majors' oligopolistic barriers.[133] Diffusion enabled host states to enter stages of the industry that had previously been monopolised by the transnationals.[134] Like new entrants in any highly restricted industry, to gain a foothold in the market, the independents competed on price. They were willing to accept lower profits and to concede greater control to host governments in return for the right to explore for and to produce oil.[135]

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[130] Vernon, Sovereignty at Bay, 53-55.

[131] Vernon, Storm Over Multinationals. Vernon had argued that increased cross-penetrating investments in European markets showed that the activities of transnationals created the conditions for competition cited in Richard S. Newfarmer, "Multinationals and Marketplace Magic in the 1980s," in The Multinational Corporation in the 1980s, ed. Charles P. Kindleberger and David B. Audretsch, (Cambridge, Mass. and London: The MIT Press, 1983), 167. As opposed to this marxists such as Rowthorn emphasised inter-imperialist competition among the United States, Western Europe and Japan B.Rowthorn, "Imperialism in the 1970s - Unity or Rivalry?" in International Firms and Modern Imperialism H. Radice ed. (Harmondsworth: Penguin, 1975) cited in Rhys Jenkins, Uneven Development, 39.

Sutowo saw explicit gains in inviting the independents who were anxious to begin exploring Indonesia's oil terrain. "The independents were more amenable to the less favourable financial terms, institutionally less difficult to supervise, and more susceptible to the pressures a host country could reasonably be expected to apply to a foreign oil company."[136] Sutowo hoped that by introducing competition into the industry, that is, if the independents agreed to relinquish management to the state, then the majors would be forced to concede.[137] Pertamina could demonstrate that the management clause would not injure the oil companies' interests. If ample acreage was pledged to independents, the majors would be unwilling to abandon the chance to exploit Indonesia's conceivably copious oil reserves.[138]

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[132] Gladwin and Walters, Multinationals Under Fire, 85.

[133] Ibid.; Howard L. Lax, State Companies: Political Risks in the International Oil Industry (New York: Praeger, 1988), 160.

[134] Stephen Kobrin, "Testing the Bargaining Hypothesis in the Manufacturing Sector in Developing Countries," International Organization 41, (Autumn 1987), 609-638; Idem, "The Forced Divestment of Foreign Enterprise in the LDCs," International Organization 34 (Winter 1980), 65-88. Also see idem, "Diffusion as an Explanation of Oil Nationalization: Or the Domino Effect Rides Again," Journal of Conflict Resolution 29, no.1 (March 1985), 3-32.

[135] David Smith and Louis T. Wells, Negotiating Third World Mineral Agreements (Cambridge, Mass: Ballinger, 1975), 12.

[136] Robert Fabrikant, "Appendix I: Production-Sharing Contracts in the Indonesian Petroleum Industry," in Asia, Oil Politics and the Energy Crisis, ed. Leon Howell and Michael Morrow. nos. 60-61. (New York: International Documentation Overseas Center, 1974), 157.

As newcomers found the Indonesian oil terrain more attractive, there was evidence of Knickerbocker's "follow the leader" or clustering effect. In his pioneering work Knickerbocker has shown how transnationals indulge in "oligopolistic reaction" or a "follow-the-leader" foreign investment behaviour pattern in which oligopolistic rivals firms rebut each other's moves in a foreign location by entering that market in close succession. Such behaviour is like buying a warranty - if all firms lose from such an investment the competitive equilibrium is maintained. If one firm is able to secure a windfall which its rivals cannot duplicate, then it can outstrip its rivals and break new ground. Knickerbocker found that industries with high overseas profit rates exhibited healthy oligopolistic reactions.[139]

In the first half of 1966, smaller independents - Cities Services, Philips, Continental Oil, Sinclair Oil, and two Japanese companies (Japex and Kyushu) which combined exploration and refining - signed production-sharing contracts in quick succession to ensure that their rivals did not have exclusive control over Indonesian contractual areas.[140] Until the mid-1960s, all Indonesian oil exploration and production had occurred onshore. Now, the independents were willing to explore the riskier offshore terrain. They succumbed to Sutowo's management demand and to Pertamina's rationalisations regarding the legality of the production-sharing contracts.[141]

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[137] Ibnu Sutowo, former President-Director Pertamina, interview by author, Jakarta, 15 January 1987.

[138] Ibid.

[139] Knickerbocker, Oligopolistic Reaction, Chapter 7.

[140] Aden, Oil and Politics, 234.

The larger independents and Mobil began seriously to consider the impact of ignoring Pertamina's production-sharing contract for their world-wide profitability. In 1968, Union Oil flew Tirto Utomo, head of Pertamina's legal division, and his team to New York to decipher the production-sharing contract.[142] The larger United States companies worried that the United States Internal Revenue Service(I.R.S.) might disallow tax credits because the production-sharing contracts denied the oil companies a legal "economic interest" in mineral resources and imposed a cost recovery limitation. Thus far the I.R.S. only admitted ownership in the concession as an economic interest and required that tax payments be calculated on generally accepted accounting principles.[143]

Tirto emphasised the state's economic interest in the mineral wealth. As the chosen representative of the state, Pertamina could legally sign business contracts without government guarantees. "The oil companies wanted to know how Pertamina would grant an economic interest to the oil companies. We argued that the partnership gave the oil companies an economic interest in oil production."[144] Utomo concluded that Pertamina's promise to uphold the terms, rights, and obligations under the so-called

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[141] Tirto Utomo S.H., Former Deputy Chief, Legal and Foreign Marketing Division, Pertamina, interview by author, Jakarta, 30 January 1987.

[142] Ibid.

[143] Ibid.

[144] Ibid.

"business contract" should amply alleviate the oil companies' concerns.[145]

Mobil broke ranks with the other majors in a round-about way on 22 July 1968. Instead of signing a formal production-sharing contract, it effectively became a production-sharing contractor when it took over the operation of Asamera's 1961 contract B-Block contract in North Sumatra. That company's gamble to find rich oil resources had failed.[146] This contract would in two years yield Mobil's big Indonesian bonanza - 17 trillion cubic feet of gas reserves and the potential for more, in Asia's largest single gas accumulation.[147] The large independents yielded - Huffco in August, IIAPCO in September, Conoco and Union in October of 1968.[148]

The oil companies had to show flexibility by recognising the state's economic interest in mineral wealth. The state had after all made a number of concessions to foreign capital. It had created stable conditions for their operations. It would cover all their Indonesian taxes; they would establish and retain complete control over their subsidiaries. More importantly, Indonesia's choicest contract areas were being snapped up by rival firms. Mobil and the larger companies had to get their foot in their door before it closed. Caltex, an incumbent major, remained unconcerned as yet. It would worry after the Tehran-Tripoli agreements.

Changing conditions in the international structure of an industry can augment or undermine a host state's bargaining power with respect to transnationals. Different host states respond differently to these changes depending on their specific position in the global structure of the industry and on internal constraints. A host state's bargaining power also depends on whether it seizes upon opportunities when they present themselves.[149]

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[145] Ibid.

[146] Mobil formalised its control on 22 July 1968. See Arun LNG Processing Agreement among Pertamina, Mobil Oil Indonesia Inc., P.T. Arun Natural Gas Liquefaction Co., 25 August 1974, Article 1.20; also see U.S. Embassy, The Petroleum Report: Indonesia (Jakarta: U.S. Embassy, 1987), 122.

[147] High-ranking government official, Jakarta, interview by author, 25 March 1987.

[148] Ibid., Appendix 3.

The buyer's market that had overshadowed much of the 1960s had prevented producer states from tilting the power balance in their favour with respect to the transnationals. But the market was undergoing a structural transformation and Libya's clash with the transnationals over prices and output provided the stimulus for a radical restructuring in the relations between oil producing states and transnationals. Qaddaffi implemented OPEC's "Declaratory Statement of Petroleum Policy of Member Countries" of the previous year which affirmed that they would control oil prices and own their oil resources.

Qaddafi pressed the transnationals to raise posted prices by US $0.40 per barrel and to curtail production. Several factors gave Qaddafi a bargaining advantage that other oil-exporting countries lacked. King Idris had wisely granted concessions to twenty-one independents. Independents produced more than half Libya's exports, compared to less than 15 percent in other oil-exporting states.[150]

Libya was the main or only profit-centre for many independents. Libyan oil was low on sulphur and the country's geographical proximity to Western Europe gave it access to a fourth of that market. Libya held the independents hostage. It played them against the majors as the bargaining "balance of power" theory predicts.[151] Qaddafi took care to bargain with the independents individually so that he would not be overpowered by their concerted strength. In this, he was aided by the oil majors. They held on to the lofty view that it was beneath them to join the independents in bargaining collectively with the host governments. The independents had no choice. They had sunken investments. For some of them, withdrawal would jeopardise their very existence. This is what bargaining theory expects.[152]

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[149] Peter B. Evans, "State, Capital, and the Transformation of Dependence: The Brazilian Computer Case," World Development 14 (1986), 803-5.

[150] Howard Lax, States and Companies, 170.

In August 1970, Qaddafi cut Occidental's production to 550,000 bpd. Qaddafi chose Occidental because it was vulnerable. It derived approximately one-third of its profits from Libyan oil and would be forced to renege on its contractual obligations to its buyers without Libyan oil. Alone, Armand Hammer, Occidental's Chief Executive Officer, could not withstand the pressure in this battle with Qaddafi. The other independents fell one by one. The majors were eventually forced to relent. Libya, in effect, was beginning to exercise control over the supply and price of its oil exports.

Libya broke the fifty/fifty profit-sharing convention. Heeding Libya's resolute course, other producing countries raised prices and increased the corporate tax to 55 percent. At their twenty-first conference in December 1970, OPEC countries proclaimed that in their revenues-sharing arrangements with the transnational corporations they would raise posted prices, end marketing discounts and tax deductions for royalties, tax the oil companies at a minimum rate of 55 percent, and conduct negotiations with the transnationals in regional forums.

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[151] Ibid., 171.

[152] Moran, Politics of Dependence, 160.

They would pursue the unilateral action route if the transnationals refused to negotiate with their collective representative bodies. OPEC had been formed precisely because the oil majors had consistently held the oil-producing countries hostage by threatening production cut-backs whenever host governments had initiated unilateral action. The oil-producing countries rendered such threats ineffective through cooperation in an oil market in which supply and demand were balanced. Through collective action, the basis of the December 1970 Caracas meeting, OPEC effected a major re-structuring in its relations with foreign oil companies.[153]

As the oil majors watched these developments they had to accept that competition had undermined their barriers to entry and that they could not prevent the erosion of their internalised, oligopolistic advantages. In the international oil industry this erosion had begun imperceptibly in the early 1950s, gaining momentum at the end of the decade. The companies had failed to contain the rate of supply in line with existing prices for very long. The Middle Eastern price of crude, the most significant price of crude, fell from US$ 2.08 to US$ 1.90 in February 1959.[154] The demand for petroleum grew and the barriers to entry began to fall in response to the standardisation of oil exploration, production, and development technologies. The seven large international firms had failed to act as a unified cartel.[155] These factors enabled the oil independents to enter the oil industry as rivals.

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[153] The oil companies had not been idle. Ever since the 1967 Suez Crisis formation of OPEC's London Oil Policy Group, the oil companies had sought to establish a joint negotiating body to combat OPEC. But in early 1971, following Qaddafi's actions and OPEC's December 1970 action to act in concert, the Nixon administration granted the U.S. oil producers permission to negotiate with OPEC. countries collectively in response to their plea that a catastrophe in the world oil industry was imminent. Peter R. Odell, Oil and World Power, 8th ed. (Harmondsworth: Penguin Books, 1986), 223-4.

[154] Penrose, Growth of Firms, 235.

The oil majors came to terms with the idea that they could no longer ignore the existence of nationalist aspirations, legislations, and bureaucracies of host governments in the countries where they held concessions. They recognised that to retain a stake in their foreign profit-centres, some compromises with host governments were warranted. They acknowledged that host states were climbing the learning curve and that their operational environment would be increasingly circumscribed.

In the fall of 1971, Caltex concluded a production-sharing contract when it noted that the contract was becoming a permanent fixture in the Indonesian oil industry with Suharto's assent.[156] It had come to terms with the practice of the theory of bilateral monopoly. According to the theory, over time the state will not respect contract sanctity. It will push the transnational to concede greater control and rents. It might nationalise the operations of a transnational, particularly if it is or was associated with colonialism. Irrespective of their political predilections, the decision-makers of a host government will strive for greater revenues.[157] Eliminating communists does not imply that economic nationalism is dead.

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[155] Ibid.

[156] High-ranking government official, interview by author, Jakarta, 15 September 1986.

[157] Moran, Politics of Dependence, chap. 6.

Although Caltex's contract provided for extension "in recognition of the requirements for appropriate cost recovery from the area" two years before its expiry,[158] Caltex took preemptive measures to prevent the immediate erosion of its 1963 contract-of-work and to prolong its contractual arrangements into the twenty-first century. "We were afraid that if we did not negotiate the contract in 1971, the issue might drag on forever."[159]

Caltex acted on the basis of three assumptions. First, that to continue its operations it must acknowledge Indonesian nationalist aspirations and not upset Indonesian sensibilities. Second, the Indonesian state might renege on the contract-of-work before it expired. Third, that the state might terminate its operations at the end of 1983 for nationalist considerations or if it could replicate Caltex's functions.[160]

Moran argues that transnationals have begun to realise that day-to-day economic nationalism may threaten their operations more significantly than radical economic nationalism. Consequently, transnationals have begun to develop strategies to combat the potency of these daily pressures and to reduce their risk and vulnerability at moments when host governments typically enjoy heightened bargaining strength. They have found ways to continue their operations despite political risk. These preemptive measures prevent the host government from following the typical balance of power bargaining pattern. As Moran argues transnationals also climb a learning curve that enables them to neutralise the power of the host government during its moments of strength.[161]

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[158] Caltex Contract of Work, 12.

[159] Fomer high-ranking corporate lawyer, interview by author, Jakarta, 17 February 1987.

[160] Ibid.

The size of a transnational's investment makes a difference. If an incumbent firm's contribution to the host country's economy is so great that its very survival depends on the foreigner's goodwill, then the firm is able to neutralise the bargaining resources that the host government would otherwise have brought to bear because of its incumbency. Caltex produced 80 percent of Indonesia's crude in 1971 and contributed to 40 percent of the Indonesian government's foreign exchange earnings. It could hold the government hostage.[162]

Powerful corporations are unwilling to concede to government demands and to risk their capital without some guarantees from host governments. The Indonesian government had to succumb to Caltex's pressure to create the institutional and legal structure to enhance the security of its operations.[163] Parliament had a law in the works which was formally passed in September 1971 that provided the much sought after government guarantee when a production-sharing contract was signed by the President.[164] A bill was introduced in Parliament in November 1970; in June 1971

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[161] T.H. Moran, "International Political Risk Assessment, Corporate Planning, and Strategies to Offset Political Risk," in Multinational Corporations: The Political Economy of Foreign Direct Investment, ed. T.H.Moran (Lexington, Mass.: Lexington Books, D.C. Heath & Company, 1985), 108; 112-15.

[162] High-ranking government official, interview by author, Calgary, 15 September 1986.

[163] Former high-ranking corporate lawyer, interview by author, Jakarta, 17 February 1987.

[164] Former high-ranking corporate lawyer, interview by author, Jakarta, 17 February 1987. Former high-ranking government lawyer, interview by author, Jakarta, 6 February 1987; Aden, Politics of Oil, chap. 4; also see Cho Oon Khong, The Politics of Oil in Indonesia: Foreign Company-Host Government Relations (Cambridge: Cambridge University Press, 1986), 31.

President Suharto issued a decree implementing some of the provisions; in September, Law No 8. of 1971 was passed.[165]

Well in advance, Caltex utilised the rationale that firms often use in bargaining with host governments: if it could not expect a financial return from an active work program and a new investment commitment in the event of contract termination in 1983, it would satisfy itself with profits from its sunken investments. It promised to maintain an active work program until 1983 only if it had an inviolable eighteen-year production-sharing contract from 1983 to 2001.[166]

> In the early 1970s, Caltex's corporate managers were rather stingy on the spine. They were reluctant to make huge investment commitments because they believed that by the year 2000 Pertamina would run the oil industry itself. I never believed in this presumption. We knew that we would not plough money into oil production because of the massive funds required for development. But we wanted Caltex to pursue an active work program until the end of 1983. Our prime reason for foreign investment was to maximise efficiency in oil production and exploration. This was why we succumbed to Caltex's demand for a production-sharing contract in 1971.[167]

In 1983, as I will show later, when the Indonesian government would seek to re-negotiate Caltex's contract in 1983, Caltex would capitalise on the knowledge that the Indonesian government did not intend to enter oil exploration and production which was also its weakness. Here again is evidence of Caltex's mastery of bilateral monopoly theory. But the company did make the concessions on management; it promised large bonuses to the state and it accepted a 30 percent share of rent for 1983 instead of the usual 35 percent that companies took in 1971. A Mobil executive noted:

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[165] U.S. Embassy, U.S. Embassy, Indonesia's Petroleum Sector (Jakarta: U.S. Embassy, 1972), 18.

[166] High-ranking government official, interview by author, Jakarta, 15 September 1986. Odell addresses this issue in his discussion of the Venezuelan government's 1974-1976 negotiations with the transnationals for contracts that were due to end in 1983-4. The Venezuelan government chose to nationalise the oil companies activities rather than succumb to this threat. Odell, Oil and World Power, 85.

[167] High-ranking government official, interview by author, Jakarta, 15 September 1986.

> Caltex's management took a good decision by negotiating the contract in advance. It looked to the future. It had huge reserves and it made good predictions about prices. Based on this analysis it offered the government U.S.$20 million in bonuses or the equivalent of almost 12 million barrels of oil for contract extension. It was a lot of money when the price of oil was only $1.67. Obviously, Pertamina's attitude was cooperative towards Caltex. In the 1970s, Pertamina was hostile towards Stanvac.[168]

This went back to Sutowo's conflict with Stanvac when the company had refused to acknowledge Sutowo's managerial privileges over Permina. "Stanvac may have achieved more if its managing-director had taken a more conciliatory attitude towards Pertamina and had acknowledged Pertamina's desire to treat foreign capital as a supplement rather than a mainstay of Indonesian development."[169] With a secure contract-of-work for the present, Stanvac's management did not seek to renegotiate its contract. But Stanvac may not have achieved Caltex's success. It produced approximately 70,000 bpd. It was relatively dispensable. It could not hold the Indonesian government hostage as Caltex could. Consequently, it was more vulnerable to host government demands.

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[168] Vice-President Finance, major oil company, interview by author, Jakarta, 23 February 1987. It was in May 1971 immediately following the April Tehran agreement, that Caltex, Calsiatic-Topco another subsidiary of Texaco and Socal (now Chevron), ARCO, Conoco, and Indonesian Offshore Operators Inc. Caltex paid the government $26 million in bonuses.

[169] Vice-President Finance, major oil company, interview by author, Jakarta, 23 February 1987.

In the late 1960s and early 1970s, the acceptance of the host state's claims to ownership and management of its natural resources by a major oil company, albeit theoretical for the time being, was a triumph in and of itself. The benefit for Caltex was that its long-term interests in Indonesia were secured. Caltex's Indonesian legal counsel in Jakarta observed:

> I informed the visiting New York representatives of Socal and Texaco that in my opinion the production-sharing contract was not a valid contract because Ibnu planned to circumvent parliament. Since the Oil and Gas law required parliamentary ratification for all regulations and contracts, the production-sharing contract and the rights and obligations that it gave to the transnationals could be deemed unconstitutional. There would be no government guarantees to the oil companies once they had ceded ownership rights to the state. Yet politically, I did express the opinion that the time was ripe for the production-sharing contract, particularly since Mobil had already signed the contract in 1968. When Texaco and Socal decided to follow suit, I congratulated them for their political foresight since I understood that from the Indonesian government's perspective it was essential that the transnationals should acknowledge the state's management and control of the natural resources. It was in the interests of Texaco and Socal to sign the contract. Pertamina had prestige and people had great faith in Ibnu Sutowo. They liked to deal with him and relied on his word of honour. If we had been caught in the red-tape, there would not be forty-five production-sharing contracts today.[170]

Conclusion

In this chapter I have shown that the state formed an alliance with foreign governments and transnational corporations. At this historical juncture, the domestic entrepreneurial class did not constitute an active ally because it lacked legitimacy and was too weak to assert itself. The reasons for this weakness and lack of legitimacy are discussed in greater detail in the textile episodes. The state was more constrained by external forces than it was autonomous at this historical juncture. It had a greater resemblance to the dependent state described by Frank than the relatively autonomous state described by Evans and Cardoso. Internally, the state was constrained by its alliance members within the state - the military and the technocrats.

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[170] Del Yuzar, former Chief Legal Counsel, P.T. Caltex Pacific Indonesia, interview by author, Jakarta, 23 January 1987.

Even if the state is strong with respect to civil society, it may be internally fragmented. But fragmentation does not necessarily mean that the state will be unable to take effective action. Effective action can take the form of a compromise in which the interests of the various alliance members are balanced, a job that Suharto did well. Consequently, Suharto's decision-making with respect to the oil industry partially satisfied the interests of all the alliance members without sacrificing any of those interests completely.

In this chapter I have taken issue with the view that has an instrumental marxist bias: that transnationals tend to capture specific sections of the state apparatus to further their interests. There is no doubt that transnationals tend to do this. But the sections of the state apparatus that are "captured" by the transnationals also have interests of their own. Consequently, when they choose to form an alliance they do so to fulfill their own interests. They are not comprador instruments taking their cues from the transnationals.

As the bargaining balance of power model expects, over time the state will seek to erode the transnationals' firm-specific advantages. It will create the institutional structure for this erosion although the erosion process may not be evident immediately. This was evident in the establishment of state enterprises and in Sutowo's implementation of the production-sharing contract with Suharto's support. However, with increasing knowledge and expertise of industry practices, the state can be expected to exercise the new structural powers that it has ascribed to itself in later years as the following chapters will show. Finally, in this chapter I have also shown how the host state can use competition to enhance its bargaining power in natural resource industries. But the international structure of the industry must favour such a move; and the state must avail the opportunities to improve its bargaining position.

Chapter 5

The Reach and Limits of Erosion

In the early stages of climbing the learning curve the state is more dependent than it is autonomous. In the first section of this chapter I show that the Indonesian state's gains under the production-sharing contract were largely theoretical. But Pertamina also began to erode the transnationals' firm-specific advantages in those areas where they are most surmountable in accordance with its limited capacities. It began to learn. In the second and third sections I show how the state takes advantage of the institutional rights that it had created for itself under the production-sharing contracts to create new institutions to infiltrate the oil companies' international markets, and to obtain a window on the internal prices that transnationals use to calculate host government taxes. I also show how the state established alliances with foreign buyers, reducing its dependency on the transnationals' intangible assets. At the same time, the state did not seek to threaten its joint-maximising interests with the transnationals which continue to exercise considerable market power. Thus, while the state bargained, it did so within the limits of its dependency.

Section I

Since a prime objective of the host government is to enhance its control over the industry in question by eroding the transnationals' firm-specific advantages, with or without undermining its joint-maximising relationship with the transnational, analysing each facet of the transnational/host government relationship in terms of erosion enables the bargaining "balance of power" analyst to determine the extent to which the host government has enhanced its bargaining power. This erosion may not be immediate. It may be purely theoretical in the short-term. But the host state may gradually make incursions on the transnational's turf to enhance its control over the industry.

After the dust had settled, following the Bratanata/Sutowo debate, the production-sharing contract was operationalised. True to his word, Sutowo and his team of bureaucrats operationalised the production-sharing contract in a flexible manner to promote joint-maximisation. "It gave birth to the institution of side letters relating to pricing, lifting of oil, and special discounts for the transnationals when they exported oil to far-away and distant consuming markets to accommodate the state-owned company's desire to capture a larger share of the Japanese market."[1]

In the short-term Bratanata had indeed been correct about Pertamina's inability to manage and control the industry. Pertamina's technological skills, money, and skilled personnel were limited. The management clause could not be implemented effectively. In the interests of joint-maximisation, the oil companies had willingly relinquished equity to retain effective operational control over production, pricing and marketing. Control can exist without ownership.[2] The oil companies operated as if they had complete equity and management privileges.

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[1] Former high-ranking corporate lawyer, interview by author, Jakarta, 17 February 1987.

[2] Donald J. Lecraw, "Bargaining Power, Ownership, and Profitability of Transnational Corporations in Developing Countries," Journal of International Business Studies 15 (Spring/Summer 1984), 27. Also see T.H.Moran, Multinationals and the Politics of Dependence: Copper in Chile (Princeton: Princeton University Press, 1974), 50.

The foreign companies controlled the three major firm-specific assets - capital, marketing, and technology. They kept the books and accounts and determined the expenditures that had been incurred for exploration and development. "Of course we had the right to see their books on a quarterly basis. But we knew nothing about the oil business so we did not know what to look for."[3]

The oil companies lifted most of the oil and sold it at realised prices - the best price that the oil companies claimed they were able to obtain at any given time - which were just confirmed by the Ministry of Economics.[4] Since the oil companies sold a large part of this crude to their sister affiliates, there was no real market price for the crude. "The vertically integrated firm invariably has the incentive to adjust international transfer prices of its subsidiaries ... to take advantage of the intricacies of corporate organisation to maximise its consolidated profits and losses."[5] It also discriminates among governments to maximise its profits and minimise its taxes.[6] Cost recovery and the division of profits between Pertamina and the foreign oil company were based on this price. For most of the oil the contract did indeed function like a profit-sharing, not a production-sharing contract.

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[3] Former high-ranking government official, interview by author, Jakarta, 19 May 1987; "The costs were subject to audit by Pertamina. These varied depending upon depreciation, the cost of production and so on. In the initial stages, Pertamina did not have the capability to determine actual costs." Corporate accountant, interview by author, 28 December 1986.

[4] Vice-President Finance, major oil company, letter to author, received 25 May 1989.

[5] Edith T. Penrose, The Large International Firm in Developing Countries: The International Petroleum Industry (London: Allen and Unwin, 1968), 272-3.

[6] Ibid., 273.

The production-sharing contract was based on the notion of what I call "split-ownership" between the host government and the foreign oil transnationals, a compromise deal that was first established in the 1963 contracts of work, and was the product of the stormy Guided Democracy period when the Communist-backed labour unions had aspired to participate in managing the transnational corporations' activities. The foreign oil companies had detested such interference in their internal affairs. As a contractor to the state, under the production-sharing and contract-of-work alike, the transnational oil company established a wholly-owned subsidiary with an independent legal existence over which the host government had no organisational control and in which it had no equity interest. The state had legal ownership over the resource.[7]

This allowed the firm to retain effective control over its intangible firm-specific assets. To access those assets, the state would have to employ the services of transnationals or to bargain with them. If the state wanted transnationals to reduce intra-firm sales, trade and service exchanges, employ nationals, share its marketing expertise and reinvest its profits, there would have to be external bargains between the state oil company and the transnationals.

Tavares and Serra argue that since Brazilian state enterprises performed roles complementary to the transnationals, the Brazilian state acted as their handmaid.[8] Evans argues that it would be difficult for the state to aid the process of capital accumulation without assisting transnational corporations.[9] But India provides a different test-case where the triple alliance was not the solution to capital accumulation. Encarnation shows that in India state enterprises did not act as companion instruments to transnationals. The state and local capital were constantly involved in a combative relationship with transnationals.[10]

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[7] Former high-ranking government lawyer, interview by author, Jakarta, 23 January 1987.

[8] M.C.Tavares and Jose Serra, "Beyond Stagnation: A Discussion of Recent Development in Brazil." in Latin America: From Dependence to Revolution ed. James Petras (New York: Wiley, 1973), 78.

State enterprises perform several different roles simultaneously. They perform social and political roles.[11] State enterprises create the public impression that they have brought industries on the "commanding heights of the economy" under their control by successfully taming exploitative private enterprises. They ensure that adequate quantities of fuel are available at affordable prices to consumers in various strata of the class structure. They may ease the operational climate for transnationals by creating the necessary infrastructure and shielding them from bureaucratic chores and the blast of public acrimony. They thus further capital accumulation by allowing transnationals to create profits for themselves and for the state by pursuing profit-oriented productive roles. But while this compartmentalised division of labour between foreign capital and state enterprises may give the impression that state enterprises do not intervene in the activities of the transnationals and indeed, complement them in capital accumulation, state enterprises and their managers do have a long-term interest in eroding the transnationals' firm-specific assets.

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[9] Peter B. Evans, Dependent Development: The Alliance of Multinational, State, and Local Capital in Brazil (Princeton, N.J.: Princeton University Press, 1979), 222.

[10] Dennis J. Encarnation, Dislodging Multinationals: India's Strategy in Comparative Perspective (Ithaca and London: Cornell University Press, 1989), 216.

[11] Gary Gereffi, The Pharmaceutical Industry and Dependency in the Third World, (Princeton: Princeton University Press, 1983), 138.

It is, therefore, essential to analyse the changing dynamic in the division of labour between the state and transnationals.[12] It is necessary to analyse the capacities of the state enterprise, its objectives, and its variegated interests that make it seem to veer towards the handmaid role in specific cases and away from it in others.[13] For instance, the state could be viewed as acting in the service of transnationals when it subsidises consumers, an action that a transnational in the business of making profits is loath to perform. But the state also has its own concerns when it pursues these tasks. These are social and/or national in nature, differing from the global and private interests of transnationals. The state can indulge in bitter confrontation on this issue with the transnationals or, in the interests of joint-maximisation which will lead to an absolute gain in its revenues, it can perform these functions that are social and national in character while allowing the transnationals to conduct the purely profit-oriented tasks.[14]

In the initial stages, the relations between foreign contractors and the Indonesian state were not conflictual. In the pre-production stage there was little room for dispute. Pertamina avoided management confrontations for fear of discouraging new investors or exploration activities.[15] The management clause gave the public impression of domestic control over natural resources.[16] Indonesian bureaucrats candidly admitted that they lacked the technological and management skills. They recognised that exercising the management clause in real terms might jeopardise joint-maximisation strategies, and thus prevent an absolute increase in revenues to the state. Pertamina accepted the reachable objective of educating itself.[17]

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[12] Evans, Dependent Development, 222.

[13] Ibid.

[14] See for instance Gerrefi's discussion of Proquivemex with transnationals surrounding the sale of Mexican barbasco. Gereffi, The Pharmaceutical Industry, 138-141. The crucial difference in this case as opposed to the Indonesian state's involvement in downstream oil activities was that the transnationals had already agreed to provide a specific quantity of oil at subsidised prices to the state oil company.

[15] Former accountant, Pertamina, interview by author, 2 April 1987; Vice-President Finance, interview by author, 12 February 1987. Also see Robert Fabrikant, "Appendix

A prime role for Pertamina was to act as a liaison between the government and the oil companies, to ease their operations, and to prevent them from becoming entangled in the bureaucratic maze. Pertamina obtained work permits and customs clearances for the companies.[18] It paid all their Indonesian taxes. Sutowo candidly noted:

> The production-sharing contract was devised to permit Pertamina to do what it could do best - provide overall guidance to the companies operating in a foreign country and take care of the political and bureaucratic problems, freeing the companies to do what they can do best - look for and produce oil and gas.[19]

The companies were gratified with their autonomy.[20] They were content that Pertamina had adopted a complementary rather than a conflictual role, performing functions that would ease the process of capital accumulation. They did not have to deal

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I: Production-Sharing Contracts in the Indonesian Petroleum Industry," in Asia, Oil Politics and the Energy Crisis, ed. Leon Howell and Michael Morrow, nos. 60-61. (New York: International Documentation Overseas Center, 1974), 157-160.

[16] Ibid.

[17] Former high-ranking government official, interview by author, Jakarta, 19 May 1987.

[18] Ibid.

[19] Ibnu Sutowo, cited in U.S. Embassy, Indonesia's Petroleum Sector (Jakarta: U.S. Embassy, 1976) 11.

[20] Corporate executive, major oil company, interview by author, 18 April 1987; Chairman, major oil company, interview by author, 5 January 1987; Corporate accountant, interview by author, Jakarta, 26 December 1986.

functions that would ease the process of capital accumulation. They did not have to deal with government agencies; they could concentrate on finding oil.[21]

Kindleberger argues that the transfer of ownership rights to the state dissipates the nationalism and xenophobia against the oil transnationals while allowing the host government to derive the management, marketing, and technical benefits of foreign investment.[22] Although legally they owned nothing and in effect were nationalised, most oil companies felt that they had greater security in Indonesia than in the Middle East and North Africa. In the oil industry, contractual rights no longer had sanctity. The possession of fewer rights reduced their visibility and their vulnerability. Their experience with Pertamina gave them confidence in the relative sanctity of contract. Indonesian state managers developed the reputation of being prudent and pragmatic.[23] A 1978 article in the CTC Reporter brought attention to this factor:

> Many host countries ... have sought to increase their participation in the decision-making process through joint ventures or various contractual arrangements. Nonetheless, decisions in many important areas are still likely to be made by the TNC which usually retains among other things, the technical expertise and management prerogatives. In the exploration sector, ... TNCs have found that joint ventures with State enterprises may diffuse nationalist objections to their control without substantially diminishing it.[24]

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[21] Fabrikant, Indonesian-Production Sharing Contracts," 159.

[22] Charles P. Kindleberger, Multinational Excursions (Cambridge, Mass.: M.I.T, 1984), 92. Kindleberger uses the stronger term nationalization. But all states did not nationalise the oil companies' assets. At the same time, they derived the same benefits through the transfer of dejure ownership rights to the state. Indonesia is a case in point.

[23] Corporate executive, major oil company, interview by author, 18 April 1987. Chairman, major oil company, interview by author, 5 January 1987. Corporate executive, independent oil company, interview by author, Jakarta, 12 January 1987.

[24] "Transnationals in World Development: A Re-examination," CTC Reporter 1 (April 1978), 4.

Pertamina also expanded into areas such as insurance, tourism, and hotel construction and provided expatriates with facilities: housing, hospitals, office buildings, an international school.[25] These latter functions were pursued to fulfill social/national objectives and to ease the transnationals' operations. Sutowo sought to generate multipliers for the Indonesian economy and to curtail foreign spending in Singapore and Australia, the two countries that expatriates consistently used to fulfill their needs for products and services that were not available in Indonesia.[26]

But even if the state cannot control and manage the industry in the immediate future, it can lay down the theoretical conditions to increase future control, the first step towards undermining the transnationals' undivided power.[27] Then the state can exercise those powers within the framework of the limitations and constraints that it encounters. But for the state to impose no conditions because it is constrained is to abdicate the bargaining terrain without even seeking to change its unequal position. Theoretical control by itself does bring certain advantages and regulatory powers to the host state.

Pertamina and the Ministry of Mines would gradually begin to erode the transnationals' firm-specific assets. Interactions on an equal and institutionalised basis between Pertamina and the foreign oil companies exposed state managers to the technical and managerial aspects of the industry.[28] Pertamina became the institutional repository for absorbing technological and managerial skills, spurring the "de-mystification" process. "Successful ventures, however, provide an incentive for the host country to develop skills and expertise appropriate to the industry."[29] This would increase Indonesian participation in the oil industry, enable Indonesians to replicate the functions of the transnationals, and to bargain from a position of knowledge rather than ignorance.

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[25] U.S. Embassy, Indonesia's Petroleum Sector (Jakarta: U.S. Embassy, 1976), 14.

[26] Former high-ranking government official, interview by author, Jakarta, 19 May 1987.

[27] Ibid.

[28] High-ranking government official, interview by author, Jakarta, 27 May 1987.

Pertamina had access to exploration information, the expertise, and the property of foreign contractors.[30] Geological information would eventually lead to an accumulated knowledge base of Indonesia's geological terrain which could be sold to new entrants when incumbent companies decided to withdraw after unsuccessful drilling operations. The state's share of rent increased; this was gradually raised from 65 percent of production to 67.5 percent and even 70 percent. The state gained guarantees of assured levels of annual income from the oil companies and a firm commitment that they would make a subsidised oil available for domestic consumption.

Host governments typically begin their intrusion on the transnationals' highly centralised and vertically integrated territory where the barriers to entry are the lowest. The state can claim ownership to natural resources and it can take-over the transnationals' downstream facilities within its territorial borders with relative ease. Downstream, the host government's bargaining power is the strongest and the transnational is most vulnerable. This is because the requisite skills are mastered with relative ease. But the state's ability to intrude in what was previously the transnational's domain is not invariably the product of intense bargaining. It may be that a state's decision to nationalise some assets coincides with a transnational's willingness to voluntarily relinquish control over what it believes are unprofitable operations.

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[29] Moran, Politics of Dependence, 164.

[30] This discussion is based on the perusal of various production-sharing contracts and interviews conducted from December 1986-September 1987.

Downstream facilities to supply the domestic market fall into this category, when host governments begin to ask reluctant transnationals to subsidise the domestic market, as I have shown in Chapter 2. Concerned as it is with its global profitability, a vertically integrated firm's investment priorities do not include subsidising the host government's domestic market. A firm may perform this task to safeguard the overall profitability of its operations in the host country. But there is invariably a great deal of reluctance on the part of the transnational oil companies to perform this role which makes it necessary for state-owned enterprises to take it on.

Kobrin emphasises that host governments have chosen the selective approach in nationalising the oil industry, confining it to those stages where they could replicate the transnationals' functions.[31] States also had to be selective once they had chosen to share in the costs and derive the benefits from the world capitalist system. They had to be able to afford compensation. Penrose argues that before a host government considers nationalisation it must include in its calculations the alternative uses to which it could have employed revenues that it will have to spend on developing the oil industry; the foreign exchange that it derives from existing investments, or could derive from potential investments, and taxes; the revenues that the government might have extracted from the oil company's continued operations; and the monies required for compensation. Aside from the difficulty of replicating the transnational's marketing functions, the host government would not achieve the transnational company's efficiency levels even if it engaged foreign technicians. Nationalisation, she argues, is only rationally justifiable when, even under conditions of reduced efficiency, the host government's revenues would be greater than those that it could hope to obtain from the transnationals. This situation would emerge if the oil companies adopted an exceedingly high discount rate.[32]

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[31] S. Kobrin, "Foreign Enterprise and Forced Divestment in LDCs," International Organization, 34 (1980), 65-88.

These conclusions are affirmed in the Indonesian case. Pertamina could not afford to nationalise Caltex's upstream assets, unable as it was to replicate the company's functions. The compensation payments would also have been prohibitive.[33] It was partially for this reason, that by claiming ownership to natural resources, the state had in legal terms rendered the issue of nationalising upstream facilities redundant. For when the transnational oil company owns nothing, nothing can be nationalised.[34] The transnational's economic interest was safeguarded in the partnership embodied in the contracts-of-work, the production-sharing contracts and the state's desire to pursue the joint-maximisation route with transnational investment.

Out of its meagre budget, the state had been better able to purchase Shell's rather out-dated downstream facilities and other assets. The bargain was calm; only a price had to be negotiated. Since this was the first time that Ibnu Sutowo and Tirto Utomo were involved in a purchase negotiation, they had no inkling of what the right price should be. They asked Royal-Dutch/Shell's managing director, J.P. van Reeven, to name a price. He suggested U.S. $175 million. Then, in the true eastern tradition, Ibnu and Tirto bargained or rather haggled over what might be a reasonable price. It was finally agreed that $110 million would be paid in five equal annual instalments on the guarantee of a promissory note signed by Sutowo. The state's decision-makers had to appear to be publicly knowledgeable, to be taking a tough position with respect to the transnationals, even if in reality their knowledge of the industry was, for the present, rather limited.[35]

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[32] Edith T. Penrose, The Growth of Firms, Middle East Oil and Other Essays (London: Frank Cass, 1971), 158-160.

[33] Former high-ranking government lawyer, interview by author, Jakarta, 23 January 1987; former high-ranking government official, interview by author, Jakarta, 19 May 1987.

[34] Former high-ranking government lawyer, interview by author, Jakarta, 23 January 1987. High-ranking government lawyer, interview by author, Jakarta, 22 March 1987.

Section II

When transnationals control pricing and can book lower prices for oil sales, the value of infiltrating their international markets is high for host states. Consequently, host states will enter the international market independently to maximise their revenues by gaining a window on the price that their crude can fetch in an arm's-length transaction and by eroding the transnationals' internal markets and transfer pricing strategies.

As was discussed in chapter 2, the oil majors took most of the crude produced by the oil exporting countries into their own systems and freely booked a price for the crude - realised or posted - which was the basis for calculating host government taxes. The latter is a price that the market, should, would or could bear. When transnationals controlled pricing, then a realised price was the price that the oil companies told host governments was the best available price. The posted price, used in the Middle East, was also a fictitious price and although it was a published price that provided some basis for comparison, it was still a price of the transnationals' choosing.

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[35] Former high-ranking government lawyer, interview by author, Jakarta, 30 January 1987.

To challenge the transnational's market power, the host state had to first obtain a contractual right to lift crude - it had to re-negotiate the oil transnational's concession contract which gave it a monopoly over crude-lifting. If it could beat the oil company's price, the state had the legal right to market 20 percent of gross production under the contract-of-work and its own share and the cost oil under the production-sharing contract. But to put this theoretical right into practice, the state had to find buyers with a vested interest in eroding the transnationals' market power and obtaining crude on an arm's-length basis.

Indonesia found this opportunity in its natural market, Japan. After the Second World War, Japan had been compelled to sign long-term supply commitments with the oil majors for 80 percent of its crude needs.[36] In exchange for the equity financing that the oil majors had provided Japan's domestic refining and marketing companies for infrastructural purposes they were expected to lift additional crude supplies. In 1966, the Japanese Petroleum Committee of the Energy Council found that despite the fall in oil prices from 1962-1965 and the increasing availability of oil supplies, the transnationals were charging 10 cents more for tied crude over the price of "free crude". These were the years when OPEC had categorically prevented the transnationals from reducing posted prices.

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[36] The whole discussion for Japanese policy and Japanese concerns has been taken from Odell, Oil and World Power, 145-56.

Japanese government officials became increasingly concerned about their country's dependence on the oil majors for 80 percent of crude imports that came mainly from the Middle East. Consequently, serious attempts to look for alternative sources of oil were set in motion. In October 1967 a Petroleum Development Public Corporation was created to coordinate and promote development and production by Japanese companies. It was authorised to provide financial aid, guarantee loans from other sources, lease exploration equipment and to give Japanese companies all the technical aid and counsel that they required to scout energy sources around the globe. The aim was to increase the Japanese-owned or controlled share of imports to 30 percent of total imports.

In addition, the calls of Japan's environmentalists for a clean atmosphere were becoming louder and more persistent as the smog from industrial growth took its toll on Japan's urban life. Strict environmental laws in the early 1970s increased the demand and the premium fetched by low-sulphur crude and liquefied natural gas (LNG). It was with the promise of these clean-burning fuels, where Indonesia's contribution would be substantial, that in 1973 the Japanese Federation of Electric Power Companies could guarantee reduced sulphur content in power plant fuel to 0.29 percent by fiscal year 1977.[37] Only the larger electricity and gas companies that were connected to the LNG. terminals could utilise natural gas. The smaller electricity companies had to use low sulphur oil. Crude was used for transportation, for gasification, and for electricity

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[37] Michael Morrow, "The Politics of Southeast Asian Oil," in Ten Years of Military in Indonesia, ed. Malcolm Caldwell, (Nottingham: Spokesman Books, 1975), 182.

These factors increased the demand for Caltex's low sulphur Minas crude. By the end of fiscal year of 1972 (ending in 31 March 1973) Indonesia supplied 14 percent of Japan's energy needs. Japan's dependence on Middle Eastern crude dropped to 80.7 percent from 90 percent in 1968. In the early 1970s, Japan bought 70 percent of Indonesia's exports, 50 percent of its crude oil and 80 percent of its refined product exports.[39]

If the host state distributes its dependency relationships across a wider spectrum - that is, if there are a larger number of agencies with which it interacts, then the potential for the state to be held hostage, such that one or a few actors control its decision-making, is considerably reduced. Japanese firms had to be more flexible than the oil majors in their agreements with host governments because they lacked experience in oil production and marketing. The oil-consuming and the oil-producing states had a common and vested interest in cooperating to reduce the international majors' control. These cooperative arrangements took the form of direct state-to-state deal and production, sales, transport, and refining agreements between the national oil companies of producing states and Japanese corporations. Vernon's prophecy in Sovereignty At Bay, that states would have to cooperate to combat the power of transnationals, was being implemented in a rudimentary way.[40]

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[39] Michael Morrow, "Indonesia: the Focal Point," 73.

[40] Vernon, Sovereignty at Bay, 64. see also his discussion in Raymond Vernon, "Sovereignty at Bay: Ten Years After," in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. Theodore H. Moran (Lexington, Mass: Lexington Books, D.C. Heath and Company, 1985), 139-158 republished from "Sovereignty at Bay: Ten Years After," International Organization 35 (Summer 1981), 517-530. His message is even more relevant in the globalisation of the 1990s as states

Indonesia's state companies began to infiltrate the Japanese market with the aid of Japanese companies. In 1964, Indonesia's two national oil companies began to look for crude outlets in Japan. In late 1964, with a Mitsubishi contract in hand, Saleh Siregar, Pertamin's President-Director, asked Caltex to raise the price to $1.63. Caltex warned Ir. Saleh Siregar, Pertamin's President-Director and Ir. Wijarso of Migas, two young Indonesian state managers who would later play leading roles in Indonesia's oil industry, that the price of $1.63 would ruin the market in six months and that the inexperienced state company should avoid selling oil independently if it wished to retain a stake in the Japanese market. But in March 1965 Wijarso offered to buy up all Caltex's crude. Caltex was forced to raise the price. As far as eroding Caltex's control over the market for Indonesian oil this was a symbolic gesture since Pertamin did not have assured marketing outlets. But from the perspective of beginning the erosion process and challenging the oil majors it was an important gesture and precedent.[41] Wijarso comments:

> International marketing outlets are a "must" in exploiting the "realised price" concept which Indonesian adopted. Within 18 months after the ratification of the contract-of-Work Pertamin started to export through its own marketing effort crude produced by its contractor. This crude, taken as payment in kind, was sold by Pertamin at a considerably higher price than had previously been claimed by the Contractor's Oil Disposal Companies as its worth in the international market. The contractor wisely accepted this fact and began increasingly to report not only its reported

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are forming regional blocs and harmonisation rules to prevent transnationals from playing them against one another. This is basically what internalisation theorists such as Rugman, Casson, and Buckley have argued all along.

[41] Ir. Wijarso, "Oil in Indonesia: In Review and Prospect," Pacific Community, 1 (July 1970).

> as payment in kind, was sold by Pertamin at a considerably higher price than had previously been claimed by the Contractor's Oil Disposal Companies as its worth in the international market. The contractor wisely accepted this fact and began increasingly to report not only its reported realised price but also the real market price.[42]

But the host state must determine whether it will expend the high costs and bear the uncertainty of creating downstream facilities in an unknown market as assured outlets for its crude or whether it will choose the second-best option of a subordinate position in a joint venture with foreign buyers. The state may exchange its dependency on the transnationals for an unequal relationship with other states or corporate actors. Pertamina did not have downstream marketing outlets. It therefore chose to establish trading companies in partnership with Japanese and American power companies and refineries.

FEOT and JIOC enabled Permina, later Pertamina, to intrude on the oil majors' Japanese markets. In Japan, these affiliates also raised finances for Pertamina's various diversification programs such as refineries through oil for finance arrangements. These relationships with Japanese refiners, industrial and electric companies did enable the state to infiltrate the Japanese market and to erode the transnationals' control over markets. But Pertamina had to accept a dependency relationship with its Japanese partners.

Sutowo made his forays in the Japanese market by establishing Far East Oil. It had 21 Japanese shareholders - refiners, power companies and industrial end-users with a 2.5 percent stake each. Pertamina had a 47.5 percent equity share. As Acting Minister of Oil and Gas, Sutowo had forced Siregar to relinquish his ambitions to market Minas crude in Japan and to leave that domain to Permina's FEOT. The company's sales increased from 3.5 million barrels to 60 million barrels in the period 1966-1972.

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[42] Wijarso, "Oil in Indonesia," 683; also see Ir. Wijarso, "Pertamina Exporting More Than One Third of Total Indonesian Oil Exports," The Indonesia Times, 23 December 1977.

But FEOT was not established to obtain the best price. It was established primarily to develop an independent marketing channel. It yielded a negotiated price in which Pertamina played a marginal role. Japanese law required that foreign oil marketing companies establish joint ventures with Japanese companies. Pertamina's inability to make direct deals with Japanese buyers gave FEOT the sole right to find buyers. "We did not speak Japanese. We could not sell oil directly to Mitsui and Mitsubishi. We did not have the expense accounts to match out Japanese counterparts in the Japanese commercial rituals of extravagant gift-giving and lavish entertainment. Most importantly, we were not insiders in the Japanese market, one of the most difficult markets to penetrate."[43] A subordinate role to its Japanese partners was a condition for breaking into the Japanese market.[44]

In 1968 Pertamina established its second marketing affiliate, Perta Oil, this time in its other natural market, the U.S. West Coast, where there was increasing demand for clean-burning fuels. In partnership with the former Californian Governor Brown, Pertamina obtained a 95 percent equity stake. The absence of language barriers, the relative openness of the United States market, and a 95 percent equity stake in the affiliate gave Pertamina much greater control over Perta's operational decisions and profits. Perta established long-term direct contractual commitments with end-users such as Sydney Power in Los Angeles. Perta succeeded in outbidding Socal on several occasions.[45]

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[43] Former high-ranking government lawyer, interview by author, Jakarta, 6 February 1987.

[44] Ibid.

In 1971 Suharto began to negotiate the creation of another marketing affiliate for which the idea originated amidst murky Japanese politics. The state apparatus was fragmented in its approach towards the establishment of this new marketing affiliate. But the transnationals did not get involved in exploiting the fragmentation within the state apparatus. Nor did the fragmentation prevent the establishment of the new marketing entity. Sutowo opposed it. He was unwilling to allow such incursions on FEOT's territory. It was now Sutowo's turn to defend the status quo. He argued that Caltex and FEOT sufficiently satisfied Indonesia's marketing needs in Japan.[46]

Sutowo did not think that it was good policy to establish a second marketing channel in Japan.[47] He concluded that the Japanese were asking for too much oil at a time when prices were rising.[48] Pertamina no longer needed to make long-term and large oil commitments for paltry loans of U.S. $200 million loans which he could now obtain with the mere strength of his signature. In addition, Pertamina was limited in the amount of oil it could exchange for loans. In normal times, when it was unable to outbid Caltex or Stanvac, Pertamina could only lift 20 percent of gross production. Pertamina was expecting to export 60 million barrels through FEOT in 1972.[49]

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[45] Ibid.

[46] High-ranking government engineer, interview by author, 25 March 1987; government official, interview by author, 17 April 1987.

[47] Sutowo granted that there had been friction between him and Suharto during the 1972 period. But he was unwilling to discuss the details. Ibnu Sutowo, former President-Director Pertamina, interview by author, Jakarta, 15 January 1987.

[48] It was in character for him to stubbornly stick to his professed perspective of what constituted good policy; it was out of character for him to challenge Suharto's authority and abilities in front of third parties. For this version of the episode see Wayne Robison, "The Politics of Japanese-Indonesian Energy Co-operation with Particular Reference to the Period 1972-1976," (Draft diss., Monash University, 1980); Aden, Oil and Politics, 245. A high level bureaucrat who attended the meeting at which Sutowo allegedly questioned Suharto's ability to conduct oil negotiations emphasises that it was a fabricated version. He argues that the Japanese parties, intent on the formation of a new oil supply channel, capitalised on the friction between Suharto and Sutowo. High-ranking government official, interview by author, Jakarta, 17 July 1987.

Even if Caltex reached the million bpd production target in 1972, Pertamina would have access to a total of 82.1 million barrels. The new marketing channel required 36.5 million barrels, leaving no oil for FEOT to commit in future years. Indeed, Sutowo would be forced to reduce commitments through FEOT. Sutowo retained the view that the technocrats did not understand oil matters. In an interview he declared that they unquestioningly and uncritically accepted his decisions in his monthly meetings with them.[50]

But Pertamina had a 47.5 percent minority share in FEOT,[51] although it had always been touted, above all by Sutowo, as a 50/50 joint venture with Japanese interests. FEOT's decision-making was controlled by its Japanese partners and they had kept a tight lid on information.[52] FEOT had been established as a "nationalist instrument" to challenge Caltex,[53] not to yield the best price.[54] It had not adequately served Pertamina's market testing requirements.[55]

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[49] It had access to 52.5 million barrels for the year from Caltex's 720,000 bpd production or 80 percent of Indonesia's total production of 892.1 bpd in 1971; 4.6 million barrels from Stanvac's 62,879 bpd production; and 14.6 million barrels from its' own 100,000 bpd production of which it exported approximately 40,000 bpd, bringing the total to 71.7 million barrels. U.S. Embassy, Indonesia's Petroleum Sector (Jakarta: U.S. Embassy, 1972), 14.

[50] Ibnu Sutowo, former President-Director Pertamina, interview by author, Jakarta, 15 January 1987.

[51] High-ranking government engineer, interview by author, Jakarta, 25 March 1987.

[52] Ibid.

The technocrats were also becoming more knowledgable about oil industry practices. Suharto and the technocrats had a different view. Having followed developments in the Middle East, they saw the opportunities and the wisdom in pursuing aggressive erosions on the transnationals' oligopolistic control over the oil industry. Qaddafi had shown them the way. They began to change their stance towards the oil companies. But as long as Sutowo monopolised the oil industry, the technocrats had little opportunity to increase their control over oil decision-making. Suharto's decision to establish a new marketing channel and Sutowo's opposition to it was a god-send. The debate between Sutowo and Suharto, conducted via third parties, had a deja vu quality. It was a re-hash of the older Bratanata/Sutowo debate - whether the state's interests were better served through competition between state enterprises or their joint ventures or through one entity's monopolistic and consolidated control. An opportunity had presented itself; Suharto would not let it pass.[56]

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[53] Government official, interview by author, Jakarta, 18 May 1987.

[54] High-ranking government engineer, interview by author, Jakarta, 25 March 1987.

[55] Ibid.

[56] Suharto also had another reason to pursue the new marketing affiliate. A year earlier Suharto and the technocrats had suffered their share of humiliation when Citibank had denied them a $200 million loan but had bestowed it on Sutowo. Now they would obtain such a loan from Japanese private and public sources. Ibnu was more creditworthy than the government." Sutowo declared that he was Indonesia's tax collector; foreign bankers treated him as such. Government official, interview by author, Jakarta, 18 May 1987. Suharto began to realise that Sutowo's power had to be limited; that the autonomy of this state manager which he had himself accorded was attaining Frankenstenian proportions.

> JIOC was created as another instrument of Pertamina to test the market for oil, to increase the channels for information, and to increase competition in the Japanese market so that we could obtain a better price. Our 50/50 partnership and our improved negotiating capacity enabled us to obtain more information about our Japanese sales from JIOC. This also forced FEOT to give us a better price since many of our JIOC partners were also our partners in FEOT.[57]

In Japan the Tehran/Tripoli agreements had created a new urgency to establish alternative supply sources. Toyota wanted a substantial equity interest in an independent supply source of low sulphur oil to ascertain the availability of gasoline for its consumers since FEOT's Japanese shareholders had preferential access to FEOT's supplies.[58] The Japanese government was sceptical about the oil majors' continued ability to provide oil on a long-term basis and frantic about establishing direct deals with governments outside the Middle East.

On 9 May 1972 President Suharto and Japanese PM Sato agreed in principle to an unparalleled government-to-government deal. The Japanese government would provide a concessional loan - a US $224 million project loan at 3 percent interest to be repaid in 25 years with seven years of grace.[59] This loan almost equalled the Japanese government's US $185 aid commitment to Indonesia through IGGI channels for 1972/1973. It was untied, available in local currency, primarily to develop Indonesia's oil resources, and outside the IGGI framework.[60] In return Suharto ironically committed

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[57] High-ranking government engineer, interview by author, 27 March 1987.

[58] Government official, interview by author, Jakarta, 18 May 1987.

[59] The first tranche of US$ 86 million was disbursed in 1973 for 16 projects to be in 1973/1974; the second tranche of US $138 million for 18 projects to be disbursed in March 1974 would flow from Japan's Overseas Economic Cooperation Fund. U.S. Embassy, Indonesia's Petroleum Sector (U.S. Embassy: Jakarta, 1974), 9.

[60] Ibid.

58 million kilolitres of "low sulpher" oil over ten years, exactly the same amount and for the same duration as Sutowo had mortgaged for his 1958 Nosodeco contract.[61] Crude oil would be sold at the prevailing market price on the date of delivery. A new marketing company, JIOC would sell the oil.[62]

In this case, the oil companies did not oppose the JIOC deal and therefore, were not subject to host government/foreign investor bargaining. Caltex did not object to the sale of another 100,000 bpd to Japan. The oil majors had come to accept the fact that the state would exercise its right to lift 20 percent of gross production. Suharto was reaping the benefits of his alliance with Caltex. Not only could he chisel away at Caltex's Japanese market share but he could use the oil reserves awaiting production as collateral for loans.

Thus the state created the institutional structure for international oil marketing and was able to increasingly participate in oil pricing. By 1977 Pertamina was exporting more than one-third of total Indonesian exports consisting of 400 m/bd crude and 150 mbd of products.[63] But the capitalist state that is more dependent than it is autonomous cannot pursue a consistently confrontational approach with respect to the transnationals. The state may pursue a confrontational and aggressive strategy with respect to the transnationals but this may jeopardise the state's other joint-maximising relations with them. Cut-throat competition jeopardises prices and threatens the absolute revenues of both parties. A fall in prices would benefit oil consumers,[64] not the host country, which does not seek prices below the internal market price quoted by the international firm to calculate host government taxes. The major oil companies could refuse to lift the oil-producing country's oil and they could persuade others not to lift the oil, which could lead to an overall reduction in production.[65]

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[61] 58 million kilolitres is equal to 364,780,000 barrels or approximately 100,000 bpd.

[62] U.S. Embassy, The Petroleum Report, 1972, 7.

[63] Wijarso, "Oil in Indonesia," 683; also see Ir. Wijarso, "Pertamina Exporting More Than One Third of Total Indonesian Oil Exports," The Indonesia Times 23 December 1977.

Pertamina could not just break into the Japanese markets of the integrated firms, even with the aid of a Japanese joint venture. It had to make certain concessions to the integrated firms to persuade them to relinquish their established markets. The state and transnationals can be expected to make trade-offs in such cases. The oil companies still exercised considerable market power. Caltex was especially powerful. Caltex produced 80 percent of Indonesia's total exports of which it lifted 80 percent. It is the entity lifting 80 percent of a particular variety of crude, not the entity lifting 20 percent of it, that will be the ultimate arbiter of the price that the crude will fetch. Wijarso commented that it was the foreign oil companies which produced more than 90 percent of Indonesian crude and had the right to sell the crude for cost recovery and their profit share that had the power to set the price for Indonesian crudes. "...therefore, Pertamina has the right - and obligation - to sell this cost-crude if the contractor cannot sell it at the price established, or required by Pertamina."[66]

Caltex had told Pertamina that it could test the market with its entitlement of 20 percent of gross production under the contract-of-work but Caltex would continue to determine realised prices for the remaining 80 percent of its production. Pertamina "could take it or leave it."[67] Perta Oil had successfully outbid Socal several times but "we still had problems in marketing and establishing the real market price." In 1969 Stanvac reduced the realised price by 2 cents. "We had to swallow it."[68]

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[64] Penrose, The Growth of the Firm, 163.
[65] Ibid.
[66] Wijarso, "Total Indonesian Oil," The Indonesia Times 23 December 1977.

In the Indonesian case, Pertamina and Caltex tacitly agreed not to compete in the same markets. Caltex would diversify markets taking crude into its own Western hemisphere system. It would leave a larger share of the Japanese market to Pertamina's affiliates. Pertamina would grant Caltex discounts on its sales to distant markets.[69] Caltex's cooperation was also necessary because the Japanese government had set a 15 percent ceiling on Indonesian oil imports.

With regard to pricing, the confrontational approach had produced less dividends than expected given Pertamina's limited means and objectives in international marketing. Immediately following the Tehran agreements Sutowo asked Caltex to raise prices to US $2.80 from US $1.70 a barrel. When Caltex refused, Sutowo left for Tokyo leaving Caltex with a pending threat that Pertamina would lift all of Caltex's crude if he could get a higher price from FEOT. He managed a 50 cent increase for Minas beginning 1 April 1971, not the US $1.10 per barrel that he had hoped for. The price of crude jumped by 30 percent to US $2.20 a barrel. Caltex was forced to follow suit. Sutowo achieved two more price increases of US $2.60 and US $2.96 on 1 October 1971 and 1

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[67] Vice-President Finance, major oil company, interview by author, Jakarta, 5 May 1987.

[68] Former high-ranking government lawyer, interview by author, 6 February 1987.

[69] Ir. Wijarso, "Total Indonesian Oil Exports," The Indonesia Times, 23 December 1977.

April 1972 respectively.[70]

The main issue here is that the transnationals' internal markets had become externalised. After the "oil price crisis of 1973 the government/Pertamina made significant changes in the price setting mechanism. (The government and Pertamina) invited input from the industry, held meetings referred to as "the crude oil market evaluation meeting" and then set prices. This was the beginning of the Government Selling Price (GSP) era."[71] The Directorate General of Migas and Pertamina moved towards negotiating prices with the industry. The larger producers - Caltex, Union Oil, Totale, Arco, IIAPCO and representatives from FEOT, JIOC, and Perta Oil were invited to discuss prices in open discussions. "We felt that we could achieve a better price through a negotiated settlement rather than by imposing a price on the oil companies."[72]

But with the right to lift all the crude of the production-sharing contractors, Pertamina's ability to test the market improved significantly. Lifting in-kind crude from the production-sharing contractors had given it the means to resolve that the contract-of-work companies had been quoting lower prices.[73] In a 1977 article, Ir. Wijarso, the Director General of Oil and Gas in Indonesia's Ministry of Mines emphasised that since Indonesia used the realised price system it was imperative for Pertamina to sell crude independently to obtain the best price in its negotiations with the foreign oil companies.[74]

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[70] Data at U.S. Embassy, Indonesia's Petroleum Sector, (1972), 9.
[71] Vice-President Finance, major oil company, letter to author, received 25 May 1989.
[72] Former Pertamina accountant, interview by author, Jakarta, 28 March 1987.
[73] Vice-President Finance, major oil company, interview by author, 11 May 1987.
[74] Wijarso, "Total Indonesian Oil Exports."

Section III

The discovery of huge quantities of natural gas and the parallel technology to develop and market it over long distances increased Pertamina's ability to erode the transnationals' control over international marketing. In 1972, when a dismayed Mobil discovered gas instead of oil in its B-Block North Sumatra contract area, the company and the US banks sought to control it.[75] It had unwittingly discovered a bonanza of 15 trillion cubic feet. Huffco found another 5 trillion feet in the Badak field in East Kalimantan.[76] Claiming ownership, Mobil started LNG negotiations with Mitsui without Sutowo's knowledge. An enraged Sutowo promised to shred Mobil's contract if the company indulged in such forays.[77] Using the legal argument that only Pertamina had the right to process oil and gas resources on Indonesian territory, he mockingly challenged Mobil's representatives to lift their share of unprocessed gas from the f.o.b. point of export and to sell it.[78] Scoffed Sutowo, "I can get cheaper credit. I can hire people. What is there that you can do that I can't do?".[79]

Sutowo and the contractors had so far paid little heed to the gas-equity split in the production-sharing contract because Indonesian gas had never been sold in international markets. The contracts gave the foreign oil companies a 70 percent production share, leaving a mere 30 percent to the government. In this confrontation, the gas-equity split was also reversed. A Mobil spokesperson would later assert, "Did we want to forego the operatorship of the LNG facility and still make such a substantial investment in developing the gas field? We went through some real soul-searching about that. ...it's very hard to generate the rate of return Mobil would have to have in view of the risk."[80] What risk was Mobil talking about? The risk of not controlling and managing the operation alone?

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[75] see also Wayne Robison, "Imperialism, Dependency, and Peripheral Industrialisation: the Case of Japan in Indonesia," in Southeast Asia: Essays in the Political Economy of Structural Change, ed. R.A. Higgot and R. Robison (London: Routledge, 1985), 206. But Mobil's production-sharing interests were never really threatened as Robison implies. See Ibid., 208.

[76] U.S. Embassy, Indonesia's Petroleum Sector (Jakarta: U.S. Embassy, 1974), 31.

[77] Ibnu Sutowo, former President-Director Pertamina, interview by author, Jakarta, 15 January 1987.

[78] Ibid.

[79] Ibid.

The intrinsic nature of natural gas[81] combined with the sovereign power of the state gave Sutowo the power to challenge the oil major, a power that he used effectively. The bureaucracy developed the expertise to defend its legal rights under the production-sharing contract. Sutowo's nimble intervention, combined with Hutapea's inspiration to use non-recourse financing, enabled Pertamina to erode Mobil's firm-specific advantages and to nudge Mobil out of the central marketing and pricing role with respect to the L.N.G. buyers. Sutowo extrapolated that role from Pertamina's monopoly over all downstream facilities within Indonesian territory. He countered Mobil's ownership claims with Pertamina's claims to mineral ownership and the principle that state sovereignty inhered in the ownership and control over all domestic marketing facilities. Having established this fact, the state bureaucracy came to the forefront to arrange non-recourse financing with the mineral wealth that it possessed. No transnational collateral was required.

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[80] Pertamina, Hands Across the Sea (Jakarta: Pertamina, 1985), 49.

[81] Transporting natural gas over long distances is the biggest problem in marketing it. Natural gas converted into methanol can be transported in conventional tankers at normal temperatures but then its uses are limited to chemical production or other industrial purposes. To use it in its natural state, the best method of transporting natural gas is in liquified form in specialised ships. The gas is liquified in a processing plant in which its temperature falls to -260 degrees Fahrenheit (-162 degrees centigrade) and its volume compressed 625-fold.

As a gas producer, Mobil's interests and power now differed from those of other major oil producers in Indonesia. Mobil had to accept a subordinate position to Pertamina as it exercised substantial control over the operational, marketing, and pricing aspects of the L.N.G. project. Marketing strength had always been a major bargaining advantage for the oil transnationals and the host government had always been forced to take a back-seat.

Indonesian state managers had gained greater expertise in pricing and contractual arrangements which reduced the transnationals' role in the negotiations with the Japanese buyers. This was the first time that Indonesian state managers occupied centre-stage in negotiating marketing arrangements, for hydro-carbon resources. A consultant to a technocrat minister who had studied the deal carefully noted, "The LNG deal was a superb demonstration of contractual craftsmanship by Wijarso and Hutapea."[82] Wijarso was solely responsible for devaluing the nobility of gas by tying the price of LNG. to oil.[83] Ir. Wijarso's negotiating style combined wit with candour. His repertoire of bargaining tactics were potent: he disarmed the most resolute of his opponents. He was and remains Indonesia's most skillful price negotiator, internationally and with the transnationals. He therefore became indispensable to the Indonesian government. Over time, he would be the sole negotiator of oil prices with the oil companies. Pertamina was able to overcome the limitations imposed by the international monetary institutions since it was unnecessary for the state to include a non-recourse loan on its balance sheets.[84]

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[82] Consultant to technocrat minister, interview by author, Jakarta, 3 February 1987.

[83] Former high-ranking government lawyer, interview by author, Jakarta, 6 February 1987; high-ranking government engineer, interview by author, Jakarta, 13 April 1987; high-ranking government official, interview by author, Jakarta, 27 May 1987.

But the state cannot erode the transnational's firm-specific advantages alone. It requires the cooperation of other powerful agencies that also have a vested interest in undermining the transnationals' integrated structure. The host government's bargaining power with respect to the foreign oil companies increases when it is able to develop alternative sources of finance through its buyers.[85] In such cases, the state can prevent the transnationals from taking the lead in negotiating deals or it can bypass them altogether. This represents a significant erosion in the transnationals' market and financial power. If the host government is successful, transnationals will have to cooperate with the state enterprise and cannot use their superior financial prowess to extract better terms from the host government.

The Japanese interest in Indonesian LNG increased the Indonesian government's bargaining power. The Japanese offer to accept LNG in return for loans to build the liquefaction plants provided the government with a new source of capital. The Japanese government's interest in reducing the majors' hold over energy imports lent additional support to the project. As Michael Shafer point out, in and of itself, project financing brings advantages to the host state.[86] It reduces the state's dependence on the transnational's equity investment.[87] It allows the state to distribute its dependency among several agencies. "Japan's EXIM Bank and the OECF would never have financed an American company's activities with soft loans on easy terms. The EXIM Bank and the Japanese government emphasised that the loan would only be given to Pertamina. Without this loan Pertamina would have been forced to accept Mobil's terms."[88]

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[84] High-ranking government engineer, interview by author, Jakarta, 25 March 1987.

[85] See also Richard S. Newfarmer, "Multinationals and Marketplace Magic in the 1980s," in The Multinational Corporation in the 1980s ed. Charles P. Kindleberger and David B. Audretsch (Cambridge, Mass. and London: The MIT Press, 1983), 183.

But Shafer also argues that if the state seeks to enter the market it must also bear the financial costs attached to an increased involvement in marketing and pricing.[89] The Indonesian case reverses this conclusion. Pertamina did finance the U.S.$1.7 billion gas liquefaction plants alone. But there were some savings for the state. Indeed, both the oil companies and the state together benefitted from the reduction in costs. If Mobil and Huffco had debt or equity financing for the projects, they would have used commercial interest rates to calculate costs. And, they would have extracted the costs from the profits generated from the project.

Non-recourse financing was a key mechanism to enhance Indonesia's leverage with foreign oil companies and to reduce its vulnerability to them. The transnationals could not utilise their firm-specific advantage, finance, to exact a higher share of rent and other benefits from the host state. Of course the approach adopted to finance the LNG project was not unique, but it served the Indonesian government's purposes. In the project-financing approach, financing is so structured that the lenders look to the project itself for repayment.[90]

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[86] Michael Shafer, "Capturing the Mineral Multinationals: Advantage or Disadvantage?" in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. Theodore H. Moran (Lexington, Mass.: Lexington Books, D.C. Heath, 1985), 38.

[87] Ibid.

[88] Nissho Iwai executive, interview by author, Tokyo, 25 August 1987.

[89] Shafer, "Mineral Multinationals," 38.

Mobil was disconcerted by its inability to sell Pertamina's share of gas as the other producers still sold Pertamina's share of crude oil. The end result would be a profit-sharing arrangement with both parties receiving their share of profits in cash, not kind, netted back to the wellhead after cost deduction. But it would be an arm's-length deal with little room for transfer pricing. As the balance of power bargaining model explains, the transnational is vulnerable when it has sunken investments and the revenue-earning potential of a project becomes known. The host government's bargaining power is at its height. The transnational must concede to the host government's demands for a greater share of revenue and for greater control over the resource. Mobil was vulnerable. It had to treat as credible Ibnu Sutowo's threat to terminate its contract. Once the bonanza was discovered, inflexibility could deprive Mobil of the rich profits that Arun would yield. Sutowo could find many willing transnationals to take up where Mobil had left off.

The management clause began to bear fruits as Sutowo challenged the oil companies in a domain that had been exclusively theirs, international oil marketing.

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[90] Norman A. White, Financing the International Petroleum Industry (London: Graham & Trotman, 1978), 73. In a strict sense, the term non-recourse is a misnomer, since there will always be recourse to some asset. Buyers and lenders do try to get a variety of guarantees in side letters. Suharto did provide an implicit government gurantee by giving public approval to the project.

Pertamina was climbing the learning curve and increasing its independence from the transnationals by eroding their firm-specific assets while retaining a dependency relationship with them. In the interests of maximising its absolute gains, the state must make certain concessions to the transnational. Even if the host state has begun to climb the learning curve, it still requires the services of the transnational to fulfill certain crucial functions. For now, Pertamina could not match the international credibility enjoyed by Mobil and Huffco. Sceptical of Pertamina's ability to launch the project on its own, the Japanese buyers would have been hard-pressed to sign a deal without the involvement of Huffco and Mobil. Ibnu Sutowo's word of honour could not supplant Pertamina's scant technical expertise. Mobil had not become superfluous. Pertamina required the technical services of a transnational, Mobil or some other company. Major corporations have established a reputation that they must protect. They will provide adequate management and attention for the orderly operation of the project.[91] Mobil's cooperation was necessary to assure the buyers that guaranteed quantities of non-associated natural gas reserves would be regularly converted into L.N.G over twenty years.

Once Mobil had accepted Sutowo's initial demands, the conditions for joint-maximisation strategies were in place.[92] A liquefied natural gas project is a classic case of joint-maximisation between the host government and a transnational corporation. Both parties have a long-term interest in the success of the project and in maximising their gains together. They enter the market as one party with respect to the buyers, not as rivals. With Mobil and Huffco lawyers and accountants at their side, Pertamina and Ministry of Mines' lawyers and bureaucrats hammered out the details of the long-term contractual arrangements - take-or-pay clauses, whether the L.N.G would be transported f.o.b. or c.i.f., and the pricing framework. And, the state was assured of an annual share of income from oil operations because the transnational oil companies could not deduct more than 40 percent of gross profits for operating costs. The state obtained a firm commitment that the transnational would contribute 25 percent of its net profits or 8.25 percent of gross profits for domestic consumption at the subsidised rate of 20 cents a barrel.

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[91] Ibid., 130-1.

[92] When the oil industry first emerged, natural gas was viewed as an annoyance that was flared for want of a better use. However, in recent decades measures have been taken to accumulate and distribute gas as an energy source. Marketing gas across the seas was a particularly ticklish problem in the absence of sophisticated transportation systems. Ibid., 125.

The government of Japan gave the Indonesian government a $200 million loan through Japan's OECF.[93] This was the only recourse element in the LNG financial package. This was also the only guarantee provided by the Government of Indonesia that the project would go ahead. It was a gesture of approval giving confidence to private commercial banks. Citibank loaned U.S.$ 260 million; the rest came from a consortium of commercial Japanese banks led by the EXIM Bank of Japan.[94] A joint corporation was established to operate the natural gas liquefaction plant in which Mobil had a 30 percent equity interest.[95] Processing was to be conducted on a non-profit, cost-of-service basis[96] to maximise upstream profits.

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[93] Article 2 in "General Agreement Concerning Project Loan to the Government of Indonesia for the Liquefied Natural Gas Development Projects" between OECF, Japan and the Government of the Republic of Indonesia, 29 March 1974; for Arun the loan would be disbursed no later than 30 June 1978. It had to be repaid in 36 semi-annual equal instalments of 883,333, 000 yen ($3.33 million) beginning 20 February 1982 and ending 20 August 1999 for a total of 31,800,000,000 yen ($120 million). I have used the March 1973 exchange rate of 265 yen to a U.S.dollar; there was a 7 year grace period. Schedule 2, Amortization Schedule in "Loan Agreement on the Items of the Liquefied Natural Gas Project Gas Development Project in Arun, Northern Sumatra," between Overseas Development Economic Cooperation Fund, Japan and the Government of Indonesia, 20 September 1974.

The LNG case demonstrates three relevant issues from a bargaining/dependency perspective. First, the state's bargaining power with respect to the oil-producing transnationals had increased. Second, state managers had gained the expertise to drive hard bargains with their foreign buyers. Third, even if they did not have the technical expertise to run the whole show, they knew what they wanted and they could hire the services of corporations that lacked their expertise. Bechtel was hired to construct the liquefaction plants. And, it was not a turnkey project. An unwilling Bechtel was forced to provide an itemised break-down of estimated costs.[97] The task of providing transportation was handed to Burmah which in turn asked General Dynamics to construct the LNG ships for an initial estimated costs of 92 million.[98]

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[94] High-ranking government engineer, interview by author, Jakarta, 27 March 1987.

[95] Letter from D.G. Little, President Mobil Oil Indonesia Inc. to Mobil LNG Indonesia Inc. New York, 15 March 1974.

[96] "Agreement on Principles of Plant lease and Processing Arrangements between Pertamina and Mobil Oil of Indonesia Inc.," 16 March 1974.

[97] Bechtel's contract runs for more than fifty pages because of this government stipulation. "Agreement between Pertamina and Bechtel Inc. for the Engineering, Procurement and Construction of LNG Production and Shipping Facilities," 2 January 1974.

[98] These costs were expected to include the actual amounts of escalation and other costs that Pertamina was expected to pay to Burmah with no profit or loss to itself. Letter from President Director Ibnu Sutowo, Pertamina to Chubu Electric Power Co. of Japan, 3 December 1973. Similar letters were sent to the other buyers Kyushu Electric Power

Conclusion

In this chapter I have demonstrated that while the state may be dependent, bargaining is still viable. Pertamina did perform the hand-maid role rather than the challenger role in the initial stages with respect to oil production and marketing. The oil companies could have control without equity. But creating the institutional rights to undermine the control of the transnationals did bring benefits. The Indonesian state began to challenge the oil companies' pricing strategies through alliances with foreign buyers and the creation of marketing agencies. Although it was not always successful, it did make some progress on this ground. Its biggest success came when it took centre-stage in bargaining with the transnationals over LNG. By then the bureaucracy had begun to ascend the learning curve rapidly and they were in a position to defend and utilise their legal rights under the production-sharing contract. Now Bratanata's initial conclusions were proven wrong. The establishment of alliances with foreign buyers enables the host state to reduce its dependency on the transnationals but it is not always in a strong bargaining position with its alternative allies.

Company, Nippon Steel, Osaka Gas and Kansai Electric.

Chapter 6

Justice in Bilateral Monopoly

The first section of this chapter demonstrates that fragmentation within the state apparatus serves the interests of transnational oil companies and prevents the state from maximising its gains in its bargains with transnationals. They do not even have to participate in setting the agenda if there are strong entrenched forces in the state apparatus whose interests coincide with their own. In this episode the two opposing forces were once again the technocrats who wanted to increase state revenues after the 1973 price increases in the international oil market and Sutowo who defied it. The relative balance of power between the two opposing forces at a particular historical juncture will determine which fraction of the state apparatus will win. But a particular state agency's unwillingness to take action against the transnationals does not necessarily stem from corruption or its comprador status. It can also stem from a different perception of the national interest and of the supply price that must be paid to transnationals so that they will continue to make massive investments in the industry. And, it can stem from an individual decision-maker's own narrow self-interest.

The second section includes a discussion of intervening variables that reduce or enhance the state's bargaining power with transnationals - the Pertamina crisis and the rise and fall of Sutowo. It also shows how state enterprises become major challengers to the states that created them and the contradictions that the creation of state enterprises produces for states.

The third section shows how once Sutowo had fallen the technocrats could implement their particular version of the national interest, substantially reducing the supply price for the oil companies' activities. But internal factors, the Pertamina crisis and external factors, the relatively sluggish oil market, intervened so that the state could not achieve all its objectives. The transnationals were able to bring their firm-specific assets to bear. But international factors enabled the state to achieve a greater share of rent than it had obtained from the oil companies before the 1973 price increases. The transnationals were also forced to make some concessions in the changing bargaining framework and the changing international environment. The end result was a positive-sum game.

Section I

Beginning in 1973 the thinking about petroleum investment among developing country decision-makers came to be governed by visions of scarcity, of constantly rising petroleum prices, and of transnationals competing feverishly for exploration acreage. Petroleum legislation, contract negotiations, and financing were dominated by these perceptions. High and rising prices enabled host governments to constantly increase oil company taxes and to impose new signature, exploration, and production bonuses. Governments were now in a position to impose new contractual conditions and interactive patterns on the oil transnationals.[1]

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[1] Review of Petroleum Investment Policies in Developing Countries ed. Nicky Beredjick and Thomas Walde in The CTC Reporter no.28 (Autumn 1988), 64.

From a historical-structural perspective, the creation of new international structures can create constraints for state action but they can also create new opportunities that enhance the state's bargaining power with transnationals. Host governments may coordinate policies and unify their approaches to the companies, strengthening their bargaining positions. OPEC was the classic illustration in this instance.[2] OPEC's emergence, changing world oil supply and demand conditions, and the concerted pressure used by that organisation on the transnationals to change their behaviour changed the structure of the international oil industry and created new opportunities for individual oil-exporting states to bargain with the oil transnationals. It also undermined the oligopolistic control that the oil companies had so far exercised over international oil production and pricing, giving individual host states the opportunity to control these processes with greater vigour. States could collectively challenge the power of the oil companies because the corporations had sunken investments and because of tight world oil market conditions. What was irreversibly laid in stone was the state's economic interest in its mineral resources which enabled it to encroach on the transnationals and to be a participant in major decisions regarding the pricing, marketing, and the volumetric output of that oil.[3]

OPEC recommended that individual countries should raise their tax rates to 85 percent which were slowly implemented. In the postwar period, governments raised taxes for oil and mineral producing transnationals which greatly surpassed tax requirements in their original contracts. Concession contracts were renegotiated. Existing tax arrangements were revoked as governments demanded higher royalties and taxes. These policies were based on the assumption that with millions of dollars at stake it would be too costly for the oil companies to discontinue production even if their net profits were considerably reduced.[4] In the years before 1930 in all likelihood host countries derived no more than 10 to 15 percent of the revenues on a barrel of oil.[5] But by the 1970s they were deriving 80 percent or more of the profits from the transnational oil companies on every barrel of oil.[6] Many of them had succeeded in significantly eroding the transnational oil companies' major reason for being in the business, their profits. The original bargain became obsolete. OPEC's triumph laid the foundations for the legitimacy of the bargaining "balance of power model" according to which, in time, the powerlessness of third world countries with respect to transnationals would decline.

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[2] Bergsten, C. Fred, Thomas Horst, and Theodore H. Moran. American Multinationals and American Interests (Washington D.C.: Brookings Institution, 1978), 121-165.

[3] Louis Turner, Oil Companies in the International System, 3d ed. (London: George Allen & Unwin, 1983), 126-127.

The conflict between Sutowo and the technocrats also played itself out in the wake of the 1973 oil price increases. When transnationals are seen to undermine the state's revenue-earning potential, there is often conflict between transnationals and the state, that is, when the transnationals' behaviour is perceived to undermine capital accumulation within the social formation as a whole.[7] When a state agency which is responsible for challenging and monitoring the activities of the transnationals seems instead to be supporting them in depriving the state of crucial revenues, then there will be conflict within the state apparatus if opposing forces exist. Moran argues "If a perception of injustice is not felt after a time by the government that originally negotiated the agreement, it can easily be created by the opponents of that government."[8]

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[4] Jack N. Behrman, "Taxation of Extractive Industries in Latin America and the Impact of Foreign Investors," in Foreign Investment in the Petroleum and Mineral Industries: Case Studies of Investor-Host Country Relations ed. Raymond F. Mikesell (Baltimore and London: The John Hopkins Press, 1971), 68.

[5] Raymond Vernon, Sovereignty at Bay: The Multinational Spread of US Enterprises (Harmondsworth: Penguin Books, 1973, Basic Books, 1971), 60.

[6] Gertrud G. Edwards, "The Frondizi Contracts and Petroleum Self-Sufficiency in Argentina," in Foreign Investment in the Petroleum and Mineral Industries: Case Studies of Investor-Host Country Relations ed. Raymond F. Mikesell (Baltimore and London: The John Hopkins Press, 1971), 157-188.

The technocrats wanted to renegotiate the production-sharing contract, to reduce the transnationals' profits and the amount that they recovered in costs. They wanted to remove the ceiling on cost recovery so that the oil companies would depreciate their assets according to generally accepted accounting principles. And they wanted to increase the government's take to 85 from 65 percent.[9] They confronted Sutowo on the issue. In their view he had ignored state interests by failing to fulfill his prime mandate: to maximise the state's revenues and monitor the transnationals' activities adequately.[10]

In this confrontation, the technocrats found support from the international financial institutions - the World Bank and the I.M.F. - whose interests do not consistently coincide with those of transnational corporations and the transnational banks.

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[7] Rhys Jenkins, Transnational Corporations and Industrial Transformation in Latin America (London: Macmillan, 1984), 186.

[8] Theodore H. Moran, Multinationals and the Politics of Dependence: Copper in Chile (Princeton: Princeton University Press, 1974), 160.

[9] Former high-ranking government official, interview by author, Jakarta, 19 May 1987; Vice-President Finance, independent oil company, interview by author, Jakarta, 12 February 1987.

[10] Former high-ranking government official, interview by author, Jakarta, 19 May 1987.

The international financial institutions are primarily concerned with a government's balance of payments stability, for which capital accumulation is essential. When the international financial institutions encourage governments to invite foreign investors, they do so in the interest of general capital accumulation, not to promote the particular interests of specific capitalists. In so far as transnationals further a state's balance of payments stability, they are to be supported.[11] But when transnationals are the main agents preventing the state from achieving that objective, the international financial institutions may support the fiscally responsible fractions of the state against transnationals. Indeed, they may support reductions in the transnationals' profits. This will became evident in the ensuing portrayal of an alliance that the Indonesian technocrats, the IMF and the World Bank forged to increase oil company taxes after the 1973 oil price bonanza.

Transnationals benefit from fragmentation within the state apparatus and tend to utilise the weaknesses engendered in state policy from different policy postures expressed by different agencies in the state apparatus.[12] The state cannot be invariably "nationalist" or entirely "comprador."[13] From 1974-1976 the oil companies benefitted from the government's inactions that flowed from the internal dispute within the state apparatus - whether to renege on the original terms of the production-sharing contract. The technocrats along with their allies, the international financial institutions and the well-known international accounting firm, Price and Waterhouse were behaving in the classic manner that the balance of power model predicts.

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[11] This statement requires qualification because one of the main criticisms levelled against the international monetary institutions has been that their promotion of foreign investment in developing countries has caused serious balance of payments difficulties for them because of the high import content of foreign investments in developing countries. The empirical results, as in the case of most criticisms of transnationals, are mixed. For instance, scholars such as Vernon, Bergsten, Horst and Moran have argued that over time host states can force the companies to increase local processing and increase the returns to the local economy. Vernon, Sovereignty at Bay, 53-65; Bergsten, Horst, and Moran, American Multinationals, 130-40. By contrast, Girvan argues that transnationals show a decided preference for imported inputs. N. Girvan, Corporate Imperialism: Conflict and Expropriation (New York: Monthly Review Press, 1976), 32-33.

Once the foreign investor has become hostage and vulnerable, and the existence of a bonanza has been proven, the host government will make new demands on the transnational corporation. The host government's envy and its urgency to stop the "injustice" is intensified when the magnitude of transnational profits is very high. This outcome is expected with greater certainty in natural resource industries.[14] When international conditions favour such demands, as the 1973-1974 price increases demonstrated, and other governments are maximising their tax, royalty and participation advantages, there is little reason for the host state to be bashful in its demands. "A change of structure may lead to a change in the behavior of actors affecting either their power or their interests.[15] But the internal conflict between Sutowo and the technocrats would produce a bashful demand.

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[12] T. Evers, El Estado en la Periferia Capitalista (Mexico City: Siglo XXI, 1979), 169-71 cited in Jenkins, Transformation in Latin America, 170.

[13] Peter B. Evans, Dependent Development: The Alliance of Multinational, State, and Local Capital in Brazil (Princeton, N.J.: Princeton University Press, 1979), 214-16.

[14] Vernon, Sovereignty at Bay, 54-60.

[15] Douglas Bennette and Kenneth Sharpe, Transnational Corporations Versus the State: The Political Economy of the Mexican Auto Industry (Princeton: Princeton University Press, 1985), 92.

Indonesia was becoming an increasingly profitable market for petroleum investment with its store-house of low sulphur crude and its geographical proximity to Japan, the world's largest and fastest growing national market for hydrocarbons. Indonesia's offshore production costs were no longer prohibitive - the assertiveness of Middle Eastern producers had taken care of that. Indonesia had become an attractive alternative supply source to companies that did not want to deal with mercurial Arabs.[16]

The foreign oil companies in Indonesia "had the sweetest deal going in the history of the international oil trade."[17] In November 1973, a concerned World Bank conservatively estimating that in 1974 the oil companies might gross US $1.70 per barrel in production and factor payments which far outstripped comparable payments in other oil producing countries, advised the technocrats to prevent such excess.[18] But the oil companies' profits far exceeded the World Bank's conservative expectations which made the issue even more worrisome. In 1974, under the 65/35 production-sharing contracts the oil transnationals in Indonesia grossed US $6.17 f.o.b on a barrel of oil that fetched US $12.60 and 40 percent, or US $5.04 for costs alone compared to the Gulf where they could only collect US $0.34 per barrel in gross profits.[19] Several oil companies, including Union and Petromar, had recovered all their capital costs within 2-3 years.[20] Some companies had deducted 70.36 percent of their costs in 1971 and 90.37 percent in 1974.[21]

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[16] Michael Morrow, "The Politics of Southeast Asian Oil," in Ten Years of Military Terror in Indonesia ed. Malcolm Caldwell (Nottingham: Spokesman Books, 1975), 183.

[17] Ibid.

[18] International Bank For Reconstruction and Development, Indonesia: Economic Report, unpublished (for official use), 30 November 1973, 16. This refrain was repeated in 1975. See Pacific Research and World Empire Telegram, July-August 1976, 13. Also see Far Eastern Economic Review, 7 November 1975, 11.

[19] Michael Morrow, "The Politics of Oil," 182.

A host government's ability to take advantage of the international and domestic opportunities to enhance its bargaining power with respect to transnationals depends on the objectives of government officials and their negotiating and technical skills.[22] Government officials can bargain most competently when they have precise knowledge about the actual profitability and technical information about a project.[23] In 1974 the technocrats did have access to information about the actual rates of return that the oil companies were obtaining on their oil investments. The introduction of the government selling price in 1973, even though it was negotiated with the oil companies individually and in concert, provided the technocrats with an external measure to calculate government taxes and the amount that the oil companies were extracting for cost recovery. The transnationals' internal market price for Indonesian crude had been eroded. It had been replaced by an external arm's-length price to calculate government taxes and the oil companies' cost recovery. What the technocrats lacked was a technical understanding of the oil industry. This would turn out to be their failing, as the later discussion in section 3 of this chapter will demonstrate.

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[20] Anthony Goldstone, "What was the Pertamina Crisis?," in Southeast Asian Affairs 1977, ed. Institute of Southeast Asian Studies (Singapore: Institute of Southeast Asian Studies, 1977), 124.

[21] Mansur Amin, " Contract of Work with Caltex: It's Like Being on the Horns of a Dilemma", Jurnal Ekuin, 5 July 1982, 2. An oil executive in Jakarta observed that between 1971-1974 some companies were deducting upto 90 percent of their costs. High-ranking corporate executive, independent oil company, interview by author, Jakarta, 26 March 1987.

[22] Richard S. Newfarmer, Transnational Conglomerates and the Economics of Dependent Development: A Case Study of the International Electrical Oligopoly and Brazil's Electrical Industry (Greenwich, Conn: Jai Press, 1977), 12.

[23] C. Vaistos, Inter-Country Income Distribution and Transnational Enterprises (Oxford: Clarendon Press, 1974), 135-147.

The flaws in the production-sharing contract became glaringly evident. The ceiling had become a tax-free loan to the companies. In a later interview, Ir. Wijarso, then the Director-General of Migas, noted that this had been completely unacceptable, defying the main rationale of the production-sharing contract, which was to limit annual cost recovery.[24] This time around Sutowo defended the oil companies' interests. He did nothing. He acted on the basis of two assumptions. First, Sutowo emphasised that his unwillingness to undermine the existing contractual arrangements was based on the technical and geological characteristics of the Indonesian oil industry.[25] It reflected his perception of Indonesia's dependency on the transnationals which he based on the reasoning that the long-term absolute revenues of the Indonesian state would be threatened by short-term gains in net revenues.

According to the theory of the bilateral monopoly there are times when either party in the conflict is content with a joint-maximisation solution that does not bring it the maximum obtainable rent. Companies and host governments may abstain from forcing their interests to the point where their short-term net revenues are earned at the price of a decrease in their long-term absolute revenues. "... the host government must continually be aware that the future level of investment of a company will be determined by its present and prospective profits."[26] The orthodox marxist Warren has argued that host countries should refrain from intemperate economic nationalism if they seek attractive levels of foreign investment.[27]

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[24] High-ranking government official, interview by author, Calgary, 15 September 1986.

[25] Former high-ranking government official, interview by author, Jakarta, 15 January 1987.

Second, and this was Sutowo's miscalculation, he did not wish to undermine the validity of the production-sharing contract. This was the inherent dilemma in the production-sharing contract, based as it was on the fundamental tenet that it was a business contract whose sanctity rested on the government's and particularly Sutowo's word of honour. Sutowo's word of honour was at stake, a quantity that had to be valued for its own sake because it brought handsome loans to the Indonesian state. Sutowo's promissory notes were as good as collateral in the banking world. Sutowo feared that one broken promise, reneging on the production-sharing contract, would bring all his creditors flocking to the Indonesian state's door demanding retribution. Having given the production-sharing contract the status of a business contract, Sutowo went on to apply the implicit moral assumptions of contract theory: once a bargain is struck it must be honoured because it represents a contract between freely consenting individuals.[28] But such assumptions prevent the state from utilising one of its most potent bargaining tools and militate against what constitutes rational behaviour for the host government according to bargaining "balance of power" lore. The rational host government is expected to care little about contract sanctity and to grasp the opportunity to change the original contract when changing domestic or international circumstances favour such an action.[29]

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[26] Behrman, "Taxation of Extractive Industries," 42; Moran argues that the host state must assess the advantages of exacting a "larger share of the existing revenue against the prospect of a large absolute amount (but a smaller share) of revenue if the investor can be induced to expand operations." Moran, Politics of Dependence, 158.

[27] Bill Warren, Imperialism: Pioneer of Capitalism (London: Verso, 1980), 176.

[28] Moran, Politics of Dependence, 168, n. 15.

When the world was hailing the fundamental structural transformation that the Middle Eastern governments had engendered in their confrontation with Western governments and the oil transnationals, what was wrong with Indonesia? Why was it passively allowing the opportunity to enrich itself pass by? This was the question that the World Bank, IMF, Price and Waterhouse and technocrats were asking: Why was Ibnu not bargaining forcefully with the transnationals for an increased share of rents when all the conditions were ripe to drive a hard bargain?[30] Scholars of the obsolescing bargain model persuasion would wonder what supply price factors underlay Sutowo's decision. Scholars with a regressive dependency world-view would brush off Sutowo's actions as just another instance of a comprador state manager too blind to recognise the state's interests since he was in league with the transnationals.

Structural power is a "higher order" power that comes from control over rules, institutions, organisations, capabilities and production processes, giving an actor or group of actors the ability to manipulate, shape, and constrain the "choices, alliances, opportunities, and payoffs"[31] for other actors. Bringing attention to structural power was the dependency perspective's major contribution to a deeper understanding of Third

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[29] Ibid., 168-9.

[30] Consultant to technocrat minister, interview by author, Jakarta, 6 February 1987.

[31] James A. Caporaso, "Introduction: Dependence and Dependency in the Global System," International Organization 32 (Winter 1978), 4.

World capitalist development. Dependency stressed the importance of analysing the manner in which global capitalism and its attendant structures such as the character of transnationals, conditioned, shaped and constrained the economic, social, and political life in Third World countries. Several scholars in the dependency/bargaining framework have argued that to understand non-decisions it is necessary to analyse structural power which determines the manner in which agendas are set and the outcomes of bargaining encounters.[32] Bachrach and Baratz have argued that non-decisions reflect political biases that allow powerful individuals or groups to defend their interests by preventing certain contentions from becoming questions of public debate.[33] Several scholars have attributed non-decisions to the lack of political will, ignorance and corruption, the structural power exercised by transnationals, or to a combination of two or more of these factors.[34] The notion of the transnationals' structural power refers to the host state's dependency that results from its participation in the capitalist system in which the basic rules for the organisation of production are set by transnational corporations.[35]

Scholars of the dynamic dependency persuasion have argued that to understand the impact of structural power in producing dependency situations, it is essential to see how "... non-decisions affect agenda setting and the outcomes of bargaining encounters."[36] But unless there is conclusive evidence of explicitly stated policies, bargaining encounters or actions leading up to a non-decision, the interpretation of a non-decision may often be the product of an analyst's subjective perception of events and situations. It is often difficult to conclusively attribute a nondecision to a decision-maker's comprador status, lack of political will, ignorance, perception of the transnationals' structural power or a combination of two or all of these factors. Again, a decision-maker may be responding to the transnationals' use of structural power to achieve certain decisional outcomes. Sutowo's response to the 1973-1974 oil price increases and his decision not to act was the product of a number of factors. It reflected his perception of Indonesia's dependency situation with respect to the transnationals. It reflected a different definition of the national interest. And, finally it reflected his own self-interest which was also tied to his notion of the national interest.

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[32] Gary Gereffi, The Pharmaceutical Industry and Dependency in the Third World (Princeton: Princeton University Press, 1983), 74-75; Bennette and Sharpe, Mexican Auto Industry, 81-2.

[33] Peter Bachrach and Morton S. Baratz, "The Two Faces of Power," American Political Science Review 56 (December 1962), 947-952.

[34] Douglas Bennette and Kenneth Sharpe, "Agenda Setting and Bargaining Power: The Mexican States Versus Transnational Automobile Corporations," World Politics, 32 (October 1979), 57-89.

[35] Peter B. Evans, "Transnational Linkages and the Economic Role of the State: An Analysis of Developing and Industrialized Nations in the Post World War II Period," in Bringing the State Back In ed. Peter B. Evans and Dietrich Reuschemeyer (Cambridge: Cambridge University Press, 1985), 218.

Ultimately host state decision-makers must negotiate to reduce the supply price that must be paid to the transnationals. Periodic negotiations between the host state and the transnationals are necessary for the host state to test the extent to which the supply price can be reduced. The normative assumption underlying the bargaining balance of power model is that it is good for the state to erode the transnationals' firm-specific advantages and profits. The rational assumption underlying the model is that the state will gradually reduce the supply price paid to the transnationals. The other facet of the rational assumption is that the state will not reduce the supply price to the point at which the transnationals will prefer to withdraw if it still requires their services.

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[36] Gerrefi, Pharmaceutical Industry, 74-5.

Sutowo did not bargain with the transnationals. His action reflected a lack of political will, although the source of that lack of political will was his perception of the national interest which did not coincide with the technocrats' vision of the national interest. Whereas the technocrats defined the state's interests in terms of increased rents and controlling the transnationals' cost recovery, Sutowo defined it in terms of increased oil exploration and development. For him, a short-term sacrifice in revenues would bring huge dividends to the government in the long run if the oil companies and Pertamina could cumulatively achieve a daily production of 2 million oil barrels by 1980, a refrain he constantly repeated.[37] Indonesia still had reserves of 15 to 17 billion and only 10 percent of Indonesia's territory had been explored.[38]

Indeed the high profits and rapid cost-recovery had yielded dramatic results. Between 1970 and 1974, 756 delineation wells were drilled resulting in 195 discoveries for an overall success ratio of 25 percent. The high "success ratio", the non-conflictual operationalisation of the production-sharing contract, the low sulphur content of Indonesian crude, and the high price of oil and natural gas made Indonesia exceedingly attractive to the foreign companies.[39] The euphoria was so great that at the Financial

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[37] Vice-President Finance, independent oil company, interview by author, Jakarta, 25 April 1987.

[38] Michael Morrow, "Indonesia: the Focal Point," in Asia, Oil Politics and the Energy Crisis ed. Leon Howell and Michael Morrow, (New York: International Documentation Overseas Center, 1974), 76.

[39] United States Embassy, Indonesia's Petroleum Sector (Jakarta: U.S. Embassy, 1975), 22.

Times/Strait Times conference on Pacific Basin Energy in December 1974 conservative production estimates of 5 million bpd for 1985 were floated when Indonesia only recorded a production high of 1.47 mbd in May 1974.[40] Oilmen had begun a rush on South East Asia to avoid "crazy and irrational" Arabs and to gain leverage with them. Japan too was increasingly looking to Indonesia to satisfy its oil needs. Sutowo was gratified with the increased reinvestment of profits that the oil companies were making.[41]

Sutowo was clearly mistaken in his assumption that the state could not extract higher rents from the transnationals even if the share that the technocrats were demanding was too high. His calculations reflected his perception of Indonesia's dependency relationship with respect to the transnationals: the negative impact that such a decision would have on their investment decisions in Indonesia. But from the perspective of the theory of bilateral monopoly Sutowo should have sought to negotiate a lower supply price with the transnationals as he had done when he initiated the production-sharing contracts instead of retreating without even testing the limits.

The companies did not get involved in what was an internal dispute within the government. Why should they get involved when the dispute enabled them to continue to maximise their profits? Now that they could recoup their investments rapidly, the oil companies did not want the cost recovery ceiling to be removed whereas they had stiffly opposed it when the production-sharing contracts were first introduced in the late

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[40] Ibid., 23.

[41] Ibnu Sutowo, former President-Director Pertamina, interview by author, Jakarta, 15 January 1987.

1960s.[42] They reaped the benefits of the high profits which they justified on rational grounds. Firms are in the business of making money and will enjoy a bonanza as long as possible. They will not gratuitously relinquish any excess profits that the government does not extract from them without pressure. In addition, the oil companies could not have done a better job of defending their interests than Sutowo.

Public reactions to this debate were delayed. The lack of public discussion on the issue aided the transnationals and Sutowo. The technocrats did not utilise economic nationalism, which had become a powerful instrument in a host state's arsenal of bargaining resources. Timing is important for a particular fraction of the state apparatus to achieve its objectives. The technocrats would have not been able to use this tool successfully in 1974 because they did not enjoy the legitimacy to garner public support for their position.

Two seahorses embedded in blue, the Pertamina insignia, a symbol of national pride and of one of Indonesia's most powerful institutions, were espied throughout the archipelago. It signified that the oil industry was firmly under Pertamina's control. Having relinquished ownership to the state, the oil companies could maintain a low profile. It was business as usual for the foreign oil companies in Indonesia during these trying years for Japanese investors in Southeast Asia, an issue that I have discussed in greater detail in my discussion on textiles. By the time Sutowo and the technocrats began to mortgage Indonesia's oil and gas wealth, the Indonesian psyche was not infrequently invaded by visitations of the phantom of Japanese colonialism. Indonesians were more concerned about Japan's consumption of Indonesia's finite resources than about the exploitative character of American corporations.

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[42] Vice-President Finance, major oil company, interview by author, Jakarta, March 6 1987.

The media may have condemned Sutowo for fiscal irresponsibility and corruption but it had never faulted him for undermining the "national interest" in his negotiations with the American oil companies. In the public eye, they had been sufficiently tamed. Sutowo was the sole recipient of the laurels of this success. The American oil companies were seen to be transferring technology sufficiently. Indonesian chief executive officers and managing directors glorified the offices of ARCO and Caltex. It was not unusual for Indonesians to head financial and legal divisions. Citibank was praised for its contributions to research and development and Caltex for building the infra-structural facilities for schools and hospitals.[43]

The American oil companies had paid their "exploitation" dues in Indonesia through the first half of the 1960s. Now it gave them a rare commodity in these fractious days - tranquil refuge when throughout the world, even at home, they were being subject to criticism and controls.[44] A few years earlier the United States embassy had quizzically observed:

> It is not surprising that foreign oil companies are not mentioned in the public debate about the role of "indigenous" entrepreneurs in Indonesia's development. If you ask an Indonesian oil official about the OPEC participation issue he will tell you it is irrelevant to Indonesia, "Indonesia

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[43] Harian Kami, 12 April 1973; Merdeka, 13 April 1973; Harian Kami, 27 April 1973.

[44] For a detailed account see Anthony Sampson, The Seven Sisters: The Great Oil Companies and the World they Made (London: Hodder and Stroughton, 1975).

> already participates in oil production management." If you ask a foreign oil company representative, he will tell you "We have already been nationalised."[45]

As a consequence, the debate remained an internal one within the state apparatus.[46] If there had been no fragmentation within the state apparatus, the Indonesian state may have obtained a better outcome. But the conflict necessitated a compromise deal between Sutowo and the technocrats that worked to the advantage of the oil transnationals. The transnationals did not even have to get involved in setting the agenda or in defending their interests. That the Indonesian state could push for a higher share of rent without undermining the investment climate became evident in the oil companies' willing acceptance of the new terms.

The timid deal that Sadli and Wijarso negotiated with the oil companies in January 1974, to which a reluctant Sutowo conceded, was an 85/15 split in diluted form.[47] Sutowo did not allow them to touch the ceiling or to implement the 85/15 split fully.[48] On 1 January 1974 Wijarso informed executives from Caltex (Standard Oil of California and Texaco), Stanvac (Exxon and Mobil), Union Oil, Atlantic Richfield, Petromar Trend, IIAPCO, and Asamera that for a weighted average price of $5.00 the equity split would remained unchanged - 60/40 for the contract-of-work and 65/35 for the production-sharing contract. Above that base price, the government would take 85 percent.[49] In a second decision, from 1 January 1975 Caltex would pay the government 90 percent and 95 percent of its operating income for production exceeding 150,000 and 250,000 bpd respectively in addition to payments under the January 1974 agreement.[50]

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[45] United States Embassy, Indonesia's Petroleum Sector, (United States Embassy: Jakarta, 1972), 8.

[46] High-ranking government accountant, interview by author, Jakarta, 16 April 1987.

[47] For an account and explanation of these changes see United States Embassy, Indonesia's Petroleum Sector (United States Embassy: Jakarta, 1975), 12-14.

[48] Former high-ranking government official, interview by author, Jakarta, 19 May 1987.

The oil companies could not resist these changes. They were vulnerable. As time passes, bargaining theory expects that sunken investments will make transnationals more susceptible to host government demands. This is especially true when the host government's demands are less onerous than those imposed by other governments in the same industry. Then the transnationals are dispossessed of their normal bargaining resources. They cannot threaten to withdraw to more hospitable environments. They also cannot threaten to deprive the host government of their firm-specific assets because in doing so, they would jeopardise their own long-term revenues. In Indonesia, the oil companies grudgingly conceded, as they realised that the balance of power within the state apparatus was shifting in favour of the technocrats. Their Indonesian operations were still extremely profitable. The market was tight and they were reaping huge profits. They could afford to be magnanimous. Caltex paid the government U.S.$ 20 million in so-called "outstanding claims."[51] They still acknowledged that the Indonesian government was giving them better terms than were available elsewhere.

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[49] High-ranking government official, interview by author, Jakarta 27 May 1987.

[50] Ibid; also see IIAPCO memorandum to Piet Haryono, President Director, Pertamina, 26 July 1976.

[51] Sutowo communicated these terms to Mines Minister Sadli who, after obtaining the President's consent, announced a price adjustment beginning on 1 April 1974. See the following government annd corporate documents: P.T. Caltex Pacific Indonesia, Memorandum to Dr. Ir. Mohammad Sadli, Minister of Mines and Energy, and Lt. General Dr. H. Ibnu Sutowo, President Director, Perusahaan Pertambangan Minyak dan Gas Bumi Negara(Pertamina), Re: Acceptance of the Additional Payments to Pertamina under the Contract of Work Following December 1973 and January 1974 Negotiations, 24 January 1974. President Suharto, Memorandum to Ir. Mohammad Sadli, Minister of

When the new tax regime allows them a favourable rate of return, companies will be flexible and will continue to make investments for future production.[52] The transnationals in Indonesia continued to expend large sums on exploration and development. Combined exploration and development expenditures by Pertamina and the oil companies exceeded $1 billion in 1975 compared to $286 million in 1972, $393 million in 1973 to $807 in 1974. A total of 182 wells were drilled. For the first time, a success ratio of 39 percent was achieved with the discovery of 71 oil and gas wells.[53]

The technocrats were not satisfied with the bashful deals. But Sutowo remained firm in his refusal to renegotiate the older contracts. Sadli continued his objections to the ceiling, out of line with reality and allowing the oil companies to recover $4.00 or more per barrel and causing great immediate losses to the Indonesian state.[54] In early 1975 pressure from Sadli and Wijarso forced Sutowo to agree to some erosions on the original

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Mines and Energy, Republic of Indonesia, Re: Suharto's Endorsement of December 1973 and January 1974 Tax Revisions, Memorandum no. B-42/M.Sekneg/1/1974, 29 January 1974. Ibnu Sutowo, President-Director, Pertamina. Letter to P.T. Caltex Pacific Indonesia, Re: Caltex's Acceptance December 1973 and January 1974 Tax Revisions, 24 January 1974. Mohammad, Sadli, Minister of Mines and Energy, letter to Ibnu Sutowo, President Director, Perusuhaan Pertambangan Minyak Dan Gas Bumi Nasional(Pertamina), Re: Additional Payments from P.T. Caltex Pacific Indonesia to the Government/Pertamina, Letter no. 163/DU/1974, 24 January 1974. Idem, Letter to President Suharto, Re: Caltex's Acceptance of December 1973 and January 1974 Tax Revisions, Letter no. 169/M.37/1974, 26 January 1974.

[52] Behrman, "Taxation of Extractive Industries," 68.

[53] U.S. Embassy, Indonesia's Petroleum Sector (U.S. Embassy: Jakarta, 1976), 20.

[54] Speech, Dr. Mohammad Sadli, Minister of Mines, Indonesia, "Indonesia's Oil and Energy Policies and Prospects, National Requirements and International Aspects" before the Australian Petroleum Exploration Association, 25 March 1974, 4. cited in U.S. Embassy, Indonesia's Petroleum Sector (Jakarta: U.S. Embassy, 1974), 23.

production-sharing contract terms for five new contracts. The new Tesoro, Tenneco, and Philips contracts limited cost recovery to 35 percent.[55] And some contracts raised the government's share of revenue to 70 and 72.5 percent. In one contract the upper limit was raised from 80 to 90 percent for production over 500,000 bpd. All five contracts incorporated the 85/15 split above the U.S.$5.00 base price formula. In March 1975 Sadli pondered over the possibility of imposing a 20-25 percent cost recovery ceiling. But it was not until Sutowo's dismissal that the technocrats would be in a position to resume their demand for an 85 percent share of oil profits and a new cost recovery schedule.

Section II

They called him the "Black Diamond", the slim, slight man with a radiating presence, frequently seen cruising in a Silver Cloud Rolls Royce inherited from Shell's long departed managing-director. General Ibnu Sutowo was fond of asserting that men in tattered attire and rusty cars could not bargain from a position of strength with high-powered, globe-trotting corporate executives. He had been busy in the past few years. By 1974, Pertamina ranked 118 on Fortune Magazine's list of the world's largest industrial enterprises; it was the biggest industrial enterprise in Asia outside Japan, with 40,000 employees, US $3.7 billion in assets and US $17 billion in annual sales. Ibnu Sutuwo controlled Indonesia's industrial development. Pertamina had an array of investments ranging from refineries, liquified natural gas, petro-chemicals, fertilisers, oil tankers, steel, airlines, hotels, highways, insurance and even experimental farming. Its budget was almost $2 billion while the government budget was only $3.66 billion. Pertamina controlled over 75 percent of Indonesia's gross foreign exchange. But it had also accumulated debt. It had as its creditors banks, supply and shipping companies, contractors, and even its own government's tax department to which it owned $800 million. The official estimate of Pertamina's indebtedness stood at US $10 billion. It included good debt such as the LNG projects, and extremely bad debt, such as over-priced tankers that never reached Indonesian shores.[56]

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[55] Petroleum and Taxation Report: Review of 1975 (New York, Gordon Barrows, 1976), 87.

From the 1950s to the 1970s there was a rapid proliferation of state-owned enterprises in the developing countries.[57] Some of these enterprises were created as part of a national program of import-substituting industrialisation. The assumptions were realist: the state was the saviour and guardian of the universal interest. The state would create its own enterprises to control strategic industries to reduce its vulnerability to foreign entities. In the developing world transnationals were considered to be a prime threat to state autonomy. This realist assumption was also shared by those who espoused the dependency perspective. The concern was shared: how best could states with weak capitalist structures control gigantic transnationals? How could state autonomy be increased? The bilateral monopoly theory was also based on the same assumption. The bilateral monopoly theory has been criticised for not providing a theory of the state, for its silence about the internal structure of the state and for its treatment of the state as an autonomous and monolithic whole.[58] But in this instance, the role of the state could be generalised. Ideology played a minor part: countries such as Indonesia, Mexico, South Korea, and Brazil that gave primacy to private capital accumulation created a public sector with the same seriousness of purpose as countries such as India and Algeria that advocated socialist principles as important components of state policy.[59]

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[56] High-ranking government official, interview by author, Jakarta, 14 January 1987.

[57] For the role of state enterprises in capital accumulation and production in Mexico and Mexico see R. Newfarmer and W. Mueller, Multinational Corporations in Brazil and Mexico: Structural Sources of Economic and Non-Economic Power Report of the Subcommittee on Multinational Corporations of the Commerce on Foreign Relations, United States Senate, Washington, U.S. Government Printing Office, 1975; also see Rhys Jenkins, Transformation in Latin America, 193-7.

There was a generally held-belief in governments that for state enterprises to pursue their mandates and specified state goals effectively they had to be granted control over adequate resources and considerable autonomy.[60] This was especially true for natural resource public enterprises whose main task was to contend with extremely powerful transnational corporations. Everywhere in the developing world, public enterprises constituted the prime "countervailing economic power" to transnational corporations.[61] Evans comments, "The most important resource that local partners may possess is political power, and the local partners with the most direct political leverage are state-owned firms."[62]

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[58] Paul Streeten, "The Theory of Development Policy," in Economic Analysis and the Multinational Enterprise ed. John H. Dunning Economic Analysis and the Multinational Enterprise (London: Allen & Unwin, 1974), 245; Richard S. Newfarmer, Transnational Conglomerates and the Economics of Dependent Development: A Case Study of the International Electrical Oligopoly and Brazil's Electrical Industry (Greenwich, Conn.: Jai Press, 1977), 338.

[59] Raymond Vernon, "Linking Managers with Ministers: Dilemmas of the State-Owned Enterprise," Journal of Policy Analysis and Management 4 (1984), 40.

[60] See for instance, Encarnation's discussion of the expanding role of state enterprises in India by the early 1970s and the great deal of financial and managerial autonomy that the government accorded them. Indeed, they emerged as major competitors to foreign and domestic private enterprise. Dennis J. Encarnation, Dislodging Multinationals: India's Strategy in Comparative Perspective (Ithaca and London: Cornell University Press, 1989), 122-132; see also Evans, Dependent Development, Chap.4 where he discusses the extensive role of state enterprises in Brazil.

[61] Newfarmer and Mueller, Structural Sources of Economic and Non-Economic Power, 55; 111.

States or their enterprises formed alliances with international finance capital to undermine the production-based transnationals and the international monetary institutions. In this instance, the state was a challenger rather than ally of transnationals. Public enterprises became consumers of large percentages of domestic finances and obtained a significant measure of credit on international money markets. From 1976 to 1983, state-owned enterprises raised over $80 billion through new bond issues offered on foreign markets.[63] It became a common state policy to give state enterprises priority over foreign manufacturing transnationals for loans raised on international financial markets to enable them to emerge as strong competitors to foreign capital.[64] "In the late 1960s, governments in such widely varied countries as Algeria, Brazil, Mexico, and South Korea ...began the systematic construction of integrated domestic structures. These nationalistic state-capitalist regimes have joined with the internationalist finance-capitalists of the Euromarkets: the banks provide the capital, the state provides the muscle and brains to force-march the countries involved into the industrialized world."[65]

In Indonesia the production-sharing contracts, based on the state's ownership of the natural resources, brought substantial benefits to Pertamina. All the government's oil revenues first appeared on Pertamina's books. In addition, Pertamina could include as its assets all proven reserves under the ground and all the capital assets used by the transnational corporations since these legally became Pertamina's property when they entered Indonesian territory. Sutowo could use these profits and assets as collateral to raise money on international money markets. This gave Pertamina tremendous solvency and creditworthiness so that Ibnu often declared, "The provisions of the production-sharing contracts are such that I am the tax-collector."[66] Indeed, without the production-sharing contract, the Pertamina crisis would not have occured.

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[62] Evans, Dependent Development, 212.

[63] Vernon, "Linking Managers with Ministers," 40; see the exponential growth of foreign capital in the form of private bank lending. Also see Jeff Frieden, "Third World Indebted Industrialization: International Finance and State Capitalism in Mexico, Brazil, Algeria, and South Korea," International Organization 35 (1981), 407.

[64] Frieden, "Third World Indebted Industrialization," 407-31.

[65] Ibid., 408.

Powerful state enterprises in the oil industry were products of the powerlessness that governments had felt in gaining access to the rich oil revenues controlled by the Seven Sisters. To name but a few, Mexico's Pemex, Petro-Can in Canada, Brazil's Petrobras, and Pertamina in Indonesia came to be treated with almost the same reverence accorded to vehicles of nirvana. State enterprises were given so much autonomy tha it inevitably created conflict within the state apparatus. Conflict between state enterprises and ministries became common in many industrialised and industrialising countries. In Indonesia this conflict took place along the already well-developed fissure between the military and civilian fractions in the state apparatus. In this conflict were involved the managers of state enterprises and the ministers and bureaucrats responsible for overseeing the implementation of state directives which included the implementation of the directives of the international financial institutions.

In Indonesia, as elsewhere, the technocrats were the enforcers of the international norms imposed by the international financial institutions which impose constraints on a state's decision-making autonomy. Industrialising countries are inextricably linked with the economies of the West; they cannot flee. The World Bank and the IMF have often forced states seeking finances on global money markets and public and private capital inflows to adopt austerity measures and adopt fiscal prudence. For this role they have been subjected to a flood of criticism for constraining the autonomy of nation-states in the interests of transnational banks and producers.[67]

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[66] Government official, interview by author, Jakarta, 21 March 1987.

To the extent that industrialising countries accepted junior partnerships in the global economy, they also adopted various Eurocentric state trappings including a finance ministry and a central bank to manage the fiscal effects and obligations of the state. These domestic institutions derived the legitimate right to control the state's resources and a monopoly over resource allocation from the Eurocentric state model. The industrialising states also accepted IMF and World Bank surveillance of their economies. Industrialising countries had to abide by these international norms if they wished to partake in the benefits that came from participating in the international state system. From a practical perspective, participation in the capitalist state system demanded that the state must not repudiate debt and it must not nationalise foreign assets.

Parallel with the emergence of state-owned enterprises, governments became increasingly concerned with managing them properly. Governments do seek to prevent state enterprises from borrowing on international financial markets.[68] But it became increasingly difficult for them to keep their promises to their allies, Western governments and the international monetary institutions, as their state enterprises continued to operate with remarkable autonomy. This also demonstrated that third world state enterprises served as instruments to challenge the state's external allies and that third world states did have interests of their own.

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[67] See for instance Robert Cox's argument about the rise of a transnational historic bloc which includes the largest transnational corporations, the international institutions such as the World Bank and the IMF, and their supporters in the advanced capitalist states. The spread and dissemination of their shared ideology leads to its solidification and continuity. Robert W. Cox, Production, Power, and World Order: Social Forces in the Making of History (New York: Columbia University Press, 1987).

Firms with promising export opportunities expanded faster than their internally generated resources permitted. The outstanding examples of balance of payments catastrophes in developing countries in the 1970s and early 1980s originated in unrestrained borrowing by rather prosperous public firms such as Mexico's Pemex and Indonesia's Pertamina. "As a result, the interaction between ministries and enterprises are bound to be permeated with struggles over the cash-flow issue, including questions about the rights of the enterprise to borrow and the obligations of the enterprise to pay taxes and dividends."[69]

While Suharto had indeed sanctioned a policy of fiscal restraint to satisfy the technocrats and the international monetary institutions who sought to control Pertamina's spending and borrowing on international money markets, he had not relinquished his dream of enhancing the prestige of his regime through capital-intensive projects. State goals, as defined by the state's top decision-makers, "... often lead(s) to an expansion in the role of state-enterprises, especially state-enterprises that have access to massive natural resource earnings."[70]

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[68] Raymond Vernon, "Linking Managers with Ministers," 49.

[69] Ibid.

> Since the government did not have adequate funds, it was the tendency of the President to turn to General Ibnu, in whom he had great confidence, and say General here is an important project, we would like you to get it done, nobody discussed where the money was to come from. So Ibnu thought he was obliged to obtain funding for projects whatever the source.[71]

During the first six years of its existence, in accordance with its policy of fiscal temperance, the New Order regime created the conditions for the unaccountability of state enterprises by encouraging them to procure foreign loans without government guarantees.[72] Within these parameters Sutowo financed all capital-intensive projects through non-governmental loans or by appropriating oil revenues before they were transferred to Bank Indonesia. This is illustrated in the acquisition of Royal Dutch/Shell's assets in 1965,[73] the nature of production-sharing contracts without government guarantees, and the purchase of Stanvac's downstream assets in 1970.

> In the process of [concretising the production-sharing contract] General

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[70] Ibid.

[71] Erland Heginbotham, Deputy Assistant Secretary, Bureau of East Asian and Pacific Affairs, Department of State, 6 October 1977, in The Witteven Facility and the OPEC Financial Surpluses Hearings Before the Sub-Committee on Foreign Economic Policy of the Committee on Foreign Relations, United States Senate, Ninety-Fifth Congress, First Session, September-October 1977, Washington, US Government Printing Office, 1978, 86.

[72] Instruction of the Presidium Minister for Economy and Finance, Sultan Hamengkubuwono IX, IN/42/MEKKU/VI/1967, June 15, 1967.

[73] Although the Rachmat Saleh, the Bank of Indonesia Governor, had first expressed his willingness to provide a government guarantee, he declined a few days later. The Royal Dutch/Shell representative had to satisfy himself with a promissory note from Sutowo. Tirto Utomo, former head of Pertamina's Legal Division, interview by author, Jakarta, 13 February 1987.

> Ibnu had demonstrated a degree of pragmatism, of reliability in contractual arrangements, and a judgement which gained for him the respect and confidence of President Soeharto and the international oil and banking communities. ...General Ibnu had by this time acquired a considerable international status and had ready access to heads of government in a variety of major industrial countries.[74]

The technocrats became increasingly powerless as Sutowo's ability to raise loans on international markets increased, a feat that the Ministry of Finance was unable to accomplish. It was also the time for Suharto to reexamine the alliance structure which seemed to endanger his own power position. "The first clash between Ibnu and Suharto occured when it was discovered that Citibank had given Sutowo a $200 million loan in early 1972 but had denied such a loan to the government."[75] To counter-balance Sutowo's power, the technocrats strengthened their alliance with the IMF and the U.S. government. In a series of decrees, the technocrats informed Sutowo that he could not borrow medium to long-term loans without their permission. But these decrees did not have their intended effect. The technocrats now enlisted the U.S. government's assistance. In late 1972 the U.S. Embassy asked the U.S. banks to exercise care in lending monies to Pertamina and to maintain close contacts with the IMF, the Bank of Indonesia, the Ministry of Finance, and the Planning Ministry.[76] IGGI was informed of Pertamina's excessive borrowing in 1973.

U.S. aid was suspended temporarily. "It was clearly felt to be in the U.S. national interest to support the technocrats in their activities because this meant a return to responsible economic policies and cooperation with international organisations.[77] Rendering this verdict as outright external interference, Sutowo raised the stakes. He began to borrow loans with a life of less than one year which he rolled over with new loans. In a later interview, Sutowo angrily defended his actions and blamed the international monetary institutions for constraining him and other third world policy makers. "Nehru had the same problem."[78]

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[74] Heginbotham, The Witteven Facility, 84.
[75] Government official, interview by author, Jakarta, 21 March 1987.
[76] Heginbotham, The Witteven Facility, 90-91.

But it was not uncommon for powerful heads of state with the authority to curb state enterprise managers to turn a blind eye to their activities and indeed to encourage them to defy their ministerial superiors. "Heads of state may be reluctant to intervene even when conflict between ministers and state managers is too important to ignore."[79] Suharto still emphatically defended Sutowo. U.S. aid was resumed shortly after Suharto told visiting U.S. Vice President Agnew in February 1973 that he himself had authorised Sutowo's activities. Even in late 1974, Suharto permitted Sutowo to raise US $500 million abroad for the state-owned Krakatau steel project and to withhold US $800 million in oil revenues from Bank Indonesia to sustain the momentum of special projects.

The Indonesian state had relinquished too much of its power to Pertamina and to the one man who ran it - Ibnu Sutowo. But it cannot be argued with conviction that Ibnu Sutowo pursued goals that were antithetical to the so called "national interest" while he enjoyed the Soeharto's support and confidence. Only later, as Suharto and Sutowo became estranged, can it be argued that Sutowo pursued interests that defied the "national interest". This of course brings us to the oft-posed question: who defines the "national interest"? In the Indonesian New Order context, Soeharto was the ultimate arbiter of what constituted the national interest, however, rashly and arbitrarily it was defined, with or without checks and balances.

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[77] Ibid., 90.

[78] Ibnu Sutowo, former President-Director Pertamina, interview by author, Jakarta, 15 January 1987.

[79] See for instance Vernon's discussion of Mexico in the early 1970s, Vernon, "Linking Managers with Ministers," 41-3.

Vernon argues that when a state-owned company is vigorously involved in productive and export functions its autonomy increases and it becomes difficult for the government to control them. "Governments then may have to face a difficult choice: whether to relinquish some measure of control over the state-owned enterprise or to reduce the probability of successful exports."[80] With respect to Latin America, Vernon writes that governments will take measures to check state enterprises when they become too independent.[81] Sutowo had to go. Not only had he destabilised the Indonesian economy and threatened the long-term viability of capitalist accumulation but he had come to threaten Suharto's position, as the Far Eastern Economic Review implicitly concluded:

> Kreshna is one of the principal characters of the wayang, Indonesia's classical shadow play. Typically, he stands on the sidelines when other characters fight, interceding only at crucial moments to mediate or tip the scales of the battle. Ibnu Sutowo's wayang character is Kreshna. Sutowo is one of the most powerful men in Indonesia today, and his name is increasingly linked to the Presidency. If not the next leader of Indonesia, so the rumours go, Sutowo will be the power broker in the game. Such speculation has its logic. On the one hand, Sutowo is unrivalled in his command of the economy. On the other hand, he appears increasingly in

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[80] Raymond Vernon, "State-Owned Enterprises in Latin-American Exports," Quarterly Review of Economics and Business 21, no. 2, (Summer 1981), 111.

[81] Ibid.

> need of resolving once and for all whether the Government will control Pertamina or Pertamina will control the government.[82]

In March 1975 the Bank of Indonesia had to cover payments of loans to the Republic National Bank of Dallas and to a group led by Toronto Dominion Bank to the tune of $45 million and $60 million respectively. But it was a full year after the Pertamina crisis became the most infamous item in Asia's industrial news columns and the technocrats had determined that Pertamina had accumulated $10 billion in loans that Suharto finally dismissed Sutowo. Still Suharto did not dismantle Pertamina. His strategies were similar to those that the Brazilian military pursued to contain Petrobras in the immediate years after 1964.[83] Few officers were charged with corruption following sweeping inquiries to uncover fraud. As in the case of Brazil's Petrobras, Suharto's most significant decision was to increase the role of technocrats in Pertamina's activities and to limit them.[84]

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[82] Far Eastern Economic Review, "Roll Me Over in Clover," 15 November 1974, 18.

[83] For a discussion of the Brazilian military's strategy towards Petrobras in the immediate years after 1964 see Thomas J. Trebat, Brazil's State-Owned Enterprises: A Case Study of the State as Entrepreneur (Cambridge: Cambridge University Press, 1983), 105-110. Of course, the difference between Pertamina and Petrobras was that after Petrobras was checked after 1964, its autonomy again expanded during the late 1960s and the early 1970s.

[84] The technocrats were given the responsibility to bring Pertamina's house in order. Minister Sumarlin charged with re-negotiating Pertamina's contracts with foreign and domestic suppliers. On April 15 1976 a technocratic military man, General Piet Haryono, who had previously served as Director-General of the State Budget in the Department of Finance, was hired as Pertamina's new President-Director. On April 15 1976 Suharto announced that Pertamina's non-oil assets would be sold to other government institutions or to private companies. The Karakatau steel complex, the Kujang fertilizer plant, and several real estate activities were removed from Pertamina's direct control. The east Kalimantan floating fertiliser plant was scrapped; the Batam Island industrial park and the Sumatran aromatics complex were postponed. United States Embassy, Indonesia's Petroleum Sector (Jakarta, U.S. Embassy, 1976), 18-9.

Section III

After the Pertamina crisis, the technocrats became more anxious to enhance the state's revenues. Sutowo's dismissal gave them the means to do so. This time they changed their strategies by garnering public support to extract greater revenues from the transnational corporations. The technocrats utilised the Pertamina crisis as well. The Pertamina crisis gave them the legitimacy to persuade Suharto that they were better able to promote the national interest. This was essential for them to gain the leverage necessary to bargain with the oil companies.

"Structures set limits to action and open up possibilities for action."[85] Timing and changes in internal and external structures have a significant impact on the ability of the state or a particular fraction in the state apparatus to take control of decision-making, to implement its version of the national interest, and become the final arbiter of what constitutes the national interest. The changing constellation of factors can create new opportunities and new constraints for decision makers. As long as Sutowo was in control of oil decision-making and had Suharto's support, the technocrats had to accept their junior status in the internal alliance within the state apparatus. The technocrats had to await changes in the internal power alliance before they could respond to the changing opportunities presented by the external environment - the structural changes in international oil markets engendered by OPEC's confrontation with the transnationals and its emergence as a formidable structure of power to challenge the oligopolistic control exercised by the oil majors.

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[85] Bennette and Sharpe, Transnational Corporations, 84.

Now that the Pertamina crisis made it possible Sutowo could be condemned for ignoring the public interest, it was easier for the technocrats to publicise the issue and to emerge as the champions of the national interest. Only two years before, they would have had difficulty persuading Suharto and the Indonesian public that in his negotiations with the transnationals, Sutowo was acting contrary to the public interest. A common tactic used by decision-makers in natural resource industries was the "transnational exploitation" as a "trump card" to arouse popular resentment against the oil companies. Host states will create perceptions of transnational exploitation and the injustice of existing contractual arrangements with foreign investors for the simple reason that they believe that the state can obtain a greater share of revenue from the natural resource industry. Little weight is given to contract sanctity, a common stratagem used by oil exporting governments. If the state agency that first negotiated an agreement with the transnationals does not create the impression of injustice, that is if it does not portray the transnationals as exploitative, then its opponents in government can generate it. Public discussion of the exploitative nature of foreign capital is a potent bargaining resource for host governments in countries which are historically associated with imperialism and have a public that is easily persuaded of the exploitative character of foreign capital. It can bring the host government huge dividends when the firm has sunken investments which it is does wish to forsake. In such cases, transnationals relinquish a larger share of their profits to the host state if they wish to stall further political opposition.[86]

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[86] Edith T. Penrose, The Growth of Firms, Middle East Oil and Other Essays (London: Frank Cass, 1971), 105.

In Indonesia, the issue of changing the split and reducing the oil companies' profits began to be discussed publicly. Tempo, the capital's leading news weekly, reported the scandalous rate at which the production-sharing contractors were recovering their costs: Petromar had deducted $4.20 for cost recovery from January to June 1976, and for June IIAPCO had deducted $5.00 per barrel.[87] The press touted Article 33 of the constitution which obliged the government to ensure that the natural resources were used to the best advantage of the Indonesian people.[88] In late July, Ekuin Minister Widjojo insisted that it was only fair that the host government should receive the economic rent from the substantial oil price increases. He argued that in the new international economic order it was "no longer the time for foreign oil companies to dredge the greatest possible profits."[89] The technocrats also elicited the support of Sheikh Yamani, the Saudi Oil Minister, during his Bali visit for the May 1976 OPEC conference. Soon after, Sadli summoned the larger production-sharing contractors, the so-called "Big Six" - Union Oil, Arco, Iiapco, Japex, Totale Indonesia, and Petromar Trend - and informed them that retroactive from 1 January 1976, the 85/15 production-split and a cost recovery schedule based on generally accepted accounted principles would replace the 65/35 split and the 40 percent cost recovery ceiling.[90]

Companies would continue to bear pre-production exploration risks and could not consolidate their profits and losses for different contract areas.[91] Two depreciation schedules were introduced so that the smaller producers could recover their costs more quickly.[92] They would continue to supply the domestic marketing obligation at cost plus U.S.$0.20 a barrel bringing the effective split to 89 percent.[93] They were given until July 31 to accept the new terms. Mobil and Huffco, the major gas producers, remained sheltered from these changes in the equity split. Their gas was as yet capped and their equity shares had been secured by the twenty-year supply contracts with the Japanese buyers.

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[87] Tempo, 3 August 1976.

[88] Ibid.

[89] Tempo, 7 August 1976.

[90] Memorandum attached to letter from Pertamina President-Director, Major-General Piet Haryono to American oil company dated 23 July 1976.

How did the technocrats and Suharto conclude that fairness and justice demanded that the state was in all righteousness entitled to a larger share of oil revenues? They drew sustenance from external factors - the changing conditions in world oil markets, and the Tehran-Tripoli agreements that instructed its members to increase state revenues to 85 percent. The government took its cues from other oil-exporting countries and decided that what was deemed fair and just for other oil exporting countries was also fair for Indonesia. They were making a significant incursion on the transnationals' turf. But it was an erosion that involved rent collection; it was not an attempt to erode any of the other facets of the relationship.

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[91] Ibid.

[92] Companies were divided into two categories: Group I with seven years or less of reserves and Group II with reserves which would give them more than seven years of production. Capital costs were to be depreciated on the basis of the double declining balance(DDB) method over a seven or fourteen year period for Group I or Group II contractors respectively. Non-capital costs could be expensed without limit, in the year of expenditure. Carry-forward capital costs would be depreciated on a seven or fourteen year basis using the DDB method. Non-capital carryforward would be depreciated on a five or ten year basis for Group I and Group II companies using a straight line method with an 8 percent interest recovery. U.S. Embassy, Indonesia's Petroleum Sector (Jakarta: U.S. Embassy, 1977), 18-20.

[93] U.S. Embassy, Indonesia's Petroleum Sector (Jakarta: U.S.Embassy, 1977), 16.

In the oil industry, the oil-producing countries had achieved a highly inequitable distribution of benefits which they believed was equitable.[94] The question that has been posed by several scholars is whether it is possible to use empirical standards to make normative evaluations of how benefits should be distributed. How is a just yield to be distinguished from an exploitative one? Penrose first sought to tackle the issue.[95] Kindleberger reframed it. In his view the relations between foreign investors and transnationals took the form of a bilateral monopoly in which the latter controlled certain coveted services - capital, technology, management, and access to foreign markets while the former controlled taxation or nationalisation. "In a typical situation a company earns more abroad than the minimum it would accept and a country's net social benefits from the company's presence are greater than the minimum it would accept... with a wide gap between maximum and minimum demands by the two parties to the bargain."[96]

For the host country, the lower limit in terms of expected returns would constitute the price necessary to attract foreign investors to make investments and not choose withdrawal. The upper limit would be the scarcity value or the price at which the host government would forgo the transnationals' services. The ultimate price that both sides would find acceptable would be somewhere in between these two boundaries and would be a function of the two contestants' negotiating capacities.[97] Moran argues that the joint-maximising relationship between host governments and foreign investors involves continuous and reciprocal modifications between foreign investors and host governments. Foreign investors will seek to promote their best interests when their bargaining power is greater and will concede to the host government's demands when they have few bargaining resources to draw upon. The host state will be also act in a similar manner.[98]

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[94] Gereffi, The Pharmaceutical Industry, 68.

[95] For Penrose's original formulation see Penrose, The Growth of Firms, 151-174.

[96] Charles P. Kindleberger and Bruce Herrick, Economic Development 3d ed. (New York: McGraw-Hill, 1977), 320.

When a reluctant Union finally accepted the new terms on July 30 Sadli triumphantly quipped, "where one sheep goes, the others will follow."[99] By August 15 all the six major production-sharing contracts had succumbed.[100] These terms effectively gave the government 89 percent of the profits. The government's foreign exchange reserves rose from US $490 million at the end of 1975 to US $1.9 billion by mid-October 1976. The government obtained an additional US $1 to US $2.50 per barrel.[101] Its revenues jumped by US $640 million for fiscal year 1976/77.[102]

Transnationals will describe the actions of a government as irrational and unreasonable. But just as transnationals are in the business of maximising their profits, governments are in the business of raising revenues. Transnationals will invoke the "contract sanctity" to undermine a government's rational decision to extract greater revenues. Governments will invoke the bargaining tools of sovereignty and justice. In a later defense of his government's decision on 6 January 1977 Suharto asserted:

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[97] Moran, "Dependentistas and Non-dependentistas," 81-82.

[98] Moran, Politics of Dependence, 169.

[99] New York Times, 7 August 1976.

[100] Ibid.

[101] Sinar Harapan, 17 January 1977.

[102] The Wall Street Journal, 12 October 1976. For the new terms also see New York Times, 7, 11, 13 August 1976. Also see New York Times, 4 September 1976.

> On the basis of the spirit of cooperation that is just and mutually beneficial in the long run, we as a country holding the sovereignty over our natural wealth have the right and even the obligation to get a more just and appropriate portion of the yield. We get that appropriate yield for the sake of development of the 135 million people, and foreign contractors will also receive reasonable profits, though a bit less than previously.[103]

The conventional joint-maximising framework based on Western contract theory assumes that only private enterprise acts morally and rationally with appropriate deference to principles of contract sanctity. In this view, host governments are described as mercurial and crazy. They are seen as being afflicted by sporadic psychological disorders which take the form of emotional eruptions that make them break perfectly just contractual arrangements and disrupt the peace and harmony characterising their relations with transnationals.[104]

Now it was the companies' turn to shift the balance of power in their favour. Vulnerable as incumbent natural resource producing companies might be, they are not bereft of bargaining resources. The static bargaining model cannot explain this. In the dynamic balance of power model, shifts in the bargaining power from transnationals to host governments and back to the transnationals must be expected over the long-term. These shifts do not imply that the host government must begin negotiating from its original position of weakness or that it must concede to all the demands of the transnationals. It often implies that the host government must give some ground.[105]

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[103] U.S. Embassy, Indonesia's Petroleum Sector (Jakarta: U.S. Embassy, 1977), 7.

[104] Moran, Politics of Dependence, 168-169.

[105] Ibid.

Transnationals undermine the government's short-term revenues by utilising delaying tactics which also serve to undermine the host government's resolve. It is also common for them to reduce their exploration and production activity and budgets and to bring the technology and capital card to bear to force the host government to temper its demands.

Investment is a continual process. Even if a host government is interested in increasing its revenues from present production, the oil companies may be unwilling to maintain the existing level of investment and exploration activity to maintain current production levels - that is, they may reduce net investment at the expense of drilling the number of wells necessary to preserve existing production levels.[106] "The proportion of its profits that a company will be willing to give up depends on its estimate of the cost of meeting final demands compared to the cost of resisting them to the point where the loss in either case makes the business unprofitable."[107]

It was not as if the companies' operations were unprofitable. The brokerage house Shuman, Agnew and Co. concluded that Natamos's Indonesian operations were very profitable despite the new revisions. By 30 September 1976, (Natamos's) oil earnings had increased by 35 percent with a further increase in profitability in the final quarter.[108] For no other reason than the state's continued dependence on the transnationals for all three of their firm-specific advantages, the oil companies in Indonesia could argue that they would only be satisfied with a profit of US$2-$2.50 per barrel. Firms will change their perceptions of what constitutes a reasonable rate of return on their investments. All of a sudden their rule-of-thumb estimates of an appropriate rate of profit jumped from 25 cents when the price of oil was $1.67 to $2-$2.50 per barrel because prices rose to US$12.60 a barrel although production costs remained relatively stable at 50 cents a barrel for offshore production and 25 cents for on-shore production in large fields such as Caltex's Minas.[109]

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[106] Behrman, "Taxation in Extractive Industries," 68.

[107] Penrose, The Growth of Firms, 153.

[108] Shuman, Agnew, and Company, "Company Report," November 1976 cited in Pacific Research, November/December 1976, 14.

The oil companies had not expected such major modifications in their equity shares or cost recovery schedules. They argued that the government was taking a short view. In the last days of July they had warned that they would fight to the bitter end.[110] Several contractors reviewed their existing and future exploration and development programs. Exploration and delineation work virtually stopped.[111] Leading the negotiations Natamos President Dorman L. Commons asserted that increased production should not be taken to mean that it was business as usual. "We are only involved in commercial development of Indonesia's fields at the moment."[112] The oil companies slammed the government for reneging on contract sanctity, for changing the cost recovery schedule, and for the 85/15 split. One oil company executive noted, "We can live with an 85%-15% split. But what has been most damaging to the confidence of the foreign oil operators has been the change in their method of cost recovery."[113] Another invoked contract sanctity:

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[109] Vice-President Finance, major oil company, interview by author, Jakarta, 6 March 1987.

[110] Tempo, 7 August 1976.

[111] Shuman, "Company Report," 14.

[112] The Wall Street Journal, 12 October 1976.

[113] Ibid.

> The oil companies did not object to contract revisions in 1974 after the four-fold price increase. ...What we do object to is when they draw a contract, when they increase their take, just to cover the debts that Ibnu Sutowo ran up. I know Indonesia needs money, but in the U.S. we believe in the sanctity of the contract. Where does it stand now? Who is going to come now and do business when contracts are re-negotiated the moment you make a profit?[114]

The oil companies set the agenda in such a manner as to deflect attention away from their highly profitable operations to the Pertamina crisis. They had no domestic allies within the state apparatus on whose support they could count. But by making it appear that Suharto and the technocrats were driven by their short-term needs to deal with the Pertamina crisis, they were able to create the impression that the government had not acted rationally. Indeed, they were so successful that even the editors of the ultra-economic nationalist paper Merdeka were convinced. Merdeka maintained that the technocrats had jeopardised the national interest by imposing "drastic" and "inappropriate" terms on the production-sharing contractors which had caused them to shift their oil rigs to Vietnam and to reduce their production when Indonesia was already facing marketing difficulties in Japan.[115] With conviction Commons noted that negotiations with the Indonesian government would bring exploration incentives within the next few months.[116]

The balance of power model expects that with a growing market for its exports, and increased locational attractiveness, the host government will be in a position to push incumbent transnationals with sunken investments to concede to its demands. This behaviour is expected even from those domestic political elites who share a similar world-view with transnational corporations. However, other things have to be equal. When they are not, after the bargain is over, the outcome may be less favourable to the host government. In the Indonesian case, its government's financial crisis served this purpose. But this was not all. There was also the legitimate concern that Sutowo had expressed - Indonesia had shallow wells which made them riskier and more expensive to develop and explore.

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[114] David Jenkins, "Jakarta's Bitter Oil Men Weigh up their Future," Far Eastern Economic Review, 13 August 1976.

[115] Merdeka, October 15 1976.

[116] The Wall Street Journal, 12 October 1976.

Michael Morrow of the Far Eastern Economic Review had cautioned that the Indonesian government would have to include in its prognostications the possible downturn in market demand that would follow the 1973-74 price hikes.[117] Indonesia's oil fields were small. Most of the production-sharing contractors had discovered minuscule fields by world standards with approximately 10-15,000 bpd.[118] Indonesia's resources did not match those of Saudi Arabia. It also meant that the Indonesian state could not aspire to the bargaining power that Saudi Arabia might achieve with respect to the transnational corporations.

> A country like Saudi Arabia, with a relatively small population, exceptionally strong balance of payments, and a command of about 140-billion barrel reserves is in a stronger bargaining position against the oil companies. A country like Indonesia, with a very large population, relatively weak balance of payments, and only 13 billion barrels in

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[117] Michael Morrow,"Oil: Catalyst for the Region," Far Eastern Economic Review, 27 December 1974, 26.

[118] Ibid.

reserves is not.[119]

Although, as a group, OPEC had increased its leverage with the oil transnationals and had transformed its relationships with them, a comparison of the strategies adopted by different OPEC countries demonstrates that they enjoyed differential levels of bargaining power with respect to transnational corporations. Countries such as Venezuela, Kuwait and Saudi Arabia began to unbundle the transnationals' firm-specific assets and to erode their internal market structure. They increased their rents and the de facto ownership of their natural resources because they had been willing and/or were able to expend the capital and to assume the geological and commercial risks attached to finding oil. For these countries, the transnational oil companies performed technical and marketing services for a nominal fee.[120] In Venezuela, the service fee to produce a barrel of oil averaged US$0.20 a barrel.[121] In contrast, Abu Dhabi, Bahrain, Ecuador, Indonesia, Libya and Nigeria continued to depend on the transnationals for a wider range of inputs. Consequently, they had to pay a higher supply price to the transnationals.[122] In political economy terms, the transnationals continued to exercise structural power that emanated from their control over key services that the host governments required. Consequently, in these countries the companies were able to resist government demands for rents equal to those in the first group of OPEC countries.

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[119] Michael Morrow, "Southeast Asian Oil," 182.

[120] For Saudi Arabia see Petroleum Economist, April 1976, 140; for Venezuela see Petroleum Economist, May 1976, 187; Petroleum Economist, January 1976, 23.

[121] Petroleum Economist, February 1976, 71.

[122] For Libya see John Wright, "Calm After Stormy Years," Petroleum Economist, November 1976, 388. For Bahrain see Petroleum Economist, November 1976, 428.

In Indonesia, Suharto and Sadli were willing to mollify the oil companies. "In the following months there was growing recognition in government circles that the state would have to modify the terms to encourage the oil companies to look for oil, especially in difficult and remote areas.[123] At a January 1977 seminar arranged by the Centre for Strategic and International Studies, the nationalist think-tank, to reassure the oil companies, Suharto promised that the government would never act arbitrarily again. Suharto and the technocrats repeated these assurances on several occasions. Sadli admitted that the renegotiations had brought the government new learning about the exploration and development requirements of the Indonesia's oil industry. "This learning process has resulted in a more flexible attitude of the Government and Pertamina."[124] But they also continued to insist that while the Pertamina crisis had been one factor in their decision to increase the government's rents, economic justice was the chief motivating factor.[125]

There are shifts in the bargaining power of the host government. But the swings in the balance of power are no longer as sharp as they were when the first concessionaire entered host territory. The relationship between transnationals and host governments is neither secular or oscillating but it is secular with oscillations. It is a process of learning about the organisational practices of capitalism and the technological requirements of the industry concerned. The structural foundations for the state's participation in the capitalist world system are strengthened as it climbs the learning curve and develops the technical expertise to understand industry practices. It is a process of learning how to use the rules of the game set by the transnationals so as to thwart them in their own game. The state develops the ability to erode the transnationals' power by learning those practices and mastering them. These are not unlearned even when other domestic and international factors - such as continued dependency on the transnationals' firm-specific assets forces the state to concede some ground to the transnationals.

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[123] Mark Johnson, "Oil I: Recent Developments," Bulletin of Indonesian Economic Studies 13 (November 1977), 39.

[124] Ibid.

[125] Speech by Mines Minister Mohammad Sadli at the Sixth Indonesian Petroleum Conference on 23 May 1977 cited in American Embassy, Indonesia's Petroleum Sector, (Jakarta: U.S. Embassy, 1977), 18.

The government did not back down on the 85/15 split. Popularising the 85/15 split had enhanced the Indonesian state's bargaining power, as the bargaining "balance of power" model expects. If their operations in the host country are sufficiently attractive, then to safeguard their long-term interests in the host country, transnationals usually refrain from causing the host state public humiliation. For rather than face humiliation, the leadership of the host state may be tempted to adopt an even more radical stance with respect to the transnationals. Suharto and the technocrats were able to save face not only with respect to Indonesia's people but also in the assemblies of OPEC. The oil companies did not demand that the government should back down on the 85/15 split.

The oil companies demanded less visible concessions so that they could raise the supply price for their services to the Indonesian government without undermining their joint-maximising relationship with it. But even in this respect the Indonesian government was selective. It had enough knowledge about the industry that it did not have to provide across the board incentives to the transnationals. It made the distinction between new and old oil. The 85/15 split and the new cost recovery schedule remained unchanged for old oil. On 11 February 1977 the government announce new incentives for new oil and secondary recovery production-sharing contractors. During the first five years of commercial production the oil companies would obtain the current market price for their domestic marketing obligation instead of the usual 20 cents plus cost on an oil barrel, 20% investment credit on gross profits, and accelerated depreciation.

But the government had not pursued the joint-maximising principle in this instance. Its short-term gains had been obtained at the expense of its long-term absolute revenues. In a later interview Ir. Wijarso conceded that the Indonesian government had paid dearly in terms of long-term revenues because of the 1976-1977 negotiations. "The result was an immediate fall of production in 1978. And of great significance, the decline could not be arrested until four years later, while during that period oil prices were at their best. It was a very expensive lesson."[126] Now as an outsider, Sutowo could argue that he had predicted that the technocrats, untutored in the oil business, with little understanding of Indonesian oil economics and its shallow oil fields, had been short-sighted. He could contend "85 percent of zero is zero. There was a big demonstration by the companies and the president promised never to do it again."[127]

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[126] Ir. Wijarso, Special Advisor to the Minister of Mines and Energy, interview by author, Calgary, 15 September 1986. Also see, Ir. Wijarso, Ministry of Mines & Energy Indonesia, "Prospects For Indonesian Oil and Gas Development and Exports," Paper presented at The International Oil and Gas Markets Conference, Calgary, Alberta, (September 14-16, 1986), 15 September 1986, 13.

[127] Ibnu Sutowo, former President-Director Pertamina, interview by author, Jakarta, 19 May 1987.

Conclusion

The conflict between Sutowo and the technocrats was ultimately a function of the supply price that they believed the Indonesian government could extract from the oil companies. For the oil companies the supply price was somewhere in between. The government might have introduced the base price system along with generally accepted accounting principles. Or it could have lowered the cost recovery ceiling to 15 to 20 percent on a barrel of oil. Sutowo's rationale and interests were different. He was interested in expanding production. His reasoning was shaped by the precepts of free enterprise: if the oil companies were allowed to enjoy a bonanza of which they re-invested a large part there would be increased production in the long-run and an overall increase in the state's absolute revenues. Visions of Indonesia producing 5 mbd by 1980 were not uncommon in those days among industry and Pertamina's technical experts. Having instituted their version of the supply price that the state could extract, which produced vociferous protests from the oil companies, Suharto and the technocrats were forced to give some ground. But they did not have to give the companies as high a supply price as they had enjoyed under the pre-1974 production-sharing contract.

Chapter 7

White-Collar Nationalism

This chapter demonstrates that an increasingly de-mystified bureaucracy will seek to regulate transnationals more stringently. Bargaining moves to a higher plane. Changing domestic and international factors aid this process. But even a dependent state which bargains with transnationals from a position of strength remains constrained by the exigencies of joint-maximisation. The first section examines the changing objectives of state decision-makers and the need for a readjustment in the alliance structure as the oil bureaucracy seeks greater autonomy from the transnationals and local firms enter the equation. The second section analyses the significance and operationalisation of changing state objectives. In the final section of this chapter and in the next two chapters, the strategies that transnationals utilise to challenge assertive state policy in a changing international environment are discussed. The final section of this chapter, demonstrates how the newly activist Indonesian state sought to bargain with the largest producer, Caltex, to enhance its control over the oil industry. It successfully obtained a larger share of rent but its other bargaining resources were neutralised because Caltex brought its firm-specific assets to bear. A conclusion is that transnationals are able to neutralise the host state's bargaining advantages as they climb their own learning curve.

Section I

The state reproduces the ideological and knowledge base within its state agencies and in civil society that is crucial to the reproduction and sustenance of capitalist production. But this process produces its own dialectic. For as elements within civil society, entrepreneurs, managerial professionals, bureaucrats, state managers, and academics gain mastery over the ideological and knowledge-based tools of capitalist production, state bureaucrats and domestic entrepreneurs acquire the capacity to bargain from a position of strength with transnationals. It is an unusual host government that will allow transnationals to operate unencumbered within its territorial space. Restrictive national policies are drafted to augment the gains from foreign investment to the local economy. Host governments normally follow a carrot and stick strategy so that they can promote national policies without undermining the foreign investment climate. They allow foreign investors favourable tax treatment, below-market loans, and tariff and non-tariff protection. But they also impose various performance requirements. These include restraints on exports or imports, production methods, employment of nationals, local research and development guidelines, the repatriation of profits, and other fiscal requirements.[1] A main aim of host governments is to impose trade restrictions on transnationals to reduce the import pressures on its balance of payments.[2]

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[1] Rachel McCulloh and Robert F. Owen, "Linking Negotiations on Trade and Foreign Direct Investment," in The Multinational Corporation in the 1980s, ed. Charles P. Kindleberger and David B. Audretsch (Cambridge, Mass. and London: The MIT Press,1983), 337.

The bargaining "balance of power" model predicts that as the host state's bureaucracy becomes de-mystified and more confident, agencies are created and strengthened to monitor transnationals, and greater administrative coherence is achieved, the state will increase its control over the transnationals' activities. There is a shift in state objectives. As state decision-makers climb the learning curve, they are no longer satisfied with higher revenues. They now seek to incorporate transnationals in a nationalist agenda that involves "job creation, industrial development, and export promotion."[3] Improved revenues and better skills "strengthen the public sector, reinforcing a preference for public control."[4] The state will participate actively in controlling oil company expenditures.

Evans, Rueschemeyer and Skocpol argue that in many industrialising states the existence of strong social actors such as transnationals has spurred the evolution of autonomy-producing capacities, sharpened bargaining faculties, and enhanced economic intervention.[5] The state has two primary functions and interests: accumulation and legitimation.[6] The tendency of governments to impose more stringent controls on transnationals emerges from their attempts to fulfill legitimation functions. But it also emerges from the accumulation function, which has two contradictory facets. On the one hand, the capitalist state must create favourable conditions for private capital accumulation, for it cannot afford to allow its sources of revenue to dry up. But it also has an interest in enhancing the revenues that it can extract from private capital.

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[2] Ibid; Shepherd notes that governments progressively tightened the import component in cigarette manufacturing in Latin America after a 5-10 year grace period. Philip L. Shepherd, "Transnational Corporations and the International Cigarette Industry," in Profits, Progress and Poverty: Case Studies of International Industries in Latin America, ed. Richard S. Newfarmer, (Notre Dame: University of Notre Dame Press, 1985).

[3] T.H. Moran, "Conclusions and Policy Implications," in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. T.H. Moran (Lexington, Mass.: Lexington Books, D.C. Heath, 1985), 266.

[4] Howard L. Lax, State Companies: Political Risks in the International Oil Industry (New York: Praeger, 1988), 147.

[5] Peter B. Evans, Dietrich Reuschemeyer and Theda Skocpol, "On the Road to a More Adequate Understanding of the State," in Bringing the State Back In ed. Peter B. Evans and Dietrich Reuschemeyer (Cambridge: Cambridge University Press, 1985), 353.

There is general agreement in the bargaining/dynamic dependency literature that the orientations, attitudes, judgments, aspirations, and demands of the state elites will determine the parameters for corporate action within the territorial confines of the host state.[7] Regimes that impose strict controls on transnationals appeal to economic nationalism to achieve legitimacy but they also achieve legitimacy by responding to economic nationalist demands.[8]

The manner in which interests are articulated and resolved within the state apparatus depends on international and domestic political forces. The interests of the state, and of other actors, change overtime. Changing national and international structures reshape the interests and power of the state. The state's interests take the form of entrenched conceptions that are adopted in response to particular issues that emerge for the state to resolve. These conceptions become solidified in particular ministries or agencies and are modified or enlarged as the structures within the international or domestic setting bring new issues to the forefront. The state must develop new approaches and strategies to deal with them. The institutionalisation of specific beliefs within the state apparatus defines the parameters of what is considered to be an issue requiring resolution by the state's decision-makers.

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[6] James O'Connor, The Fiscal Crisis of the State (New York: St. Martin's Press), 1973.

[7] Joseph LaPalombara and Stephen Blank, Multinational Corporations in Comparative Perspective (New York: The Conference Board, 1977), 71.

[8] Rhys Jenkins, Transnational Corporations and Industrial Transformation in Latin America (London: Macmillan, 1984); T.H. Moran, Multinationals and the Politics of Dependence: Copper in Chile (Princeton: Princeton University Press, 1974), 190; see also Miles Kahler, "Political Regimes and Economic Actors: The Response of Firms to the End of Colonial Rule," World Politics 33 (1981), 383-412.

The relative power of the ministries and agencies involved in the formulation and implementation of policies, and the relationships among them, affect the state's ability to carry out its policies.[9] A strong government is essential to establish industrial priorities, to negotiate with transnationals, and to implement decisions. If the state seizes the opportunity to implement well-planned policies, its bargaining power with transnationals can be increased considerably.[10] The effectiveness, capacity, and consistency displayed by what Stepan calls the "strategic state elite" will significantly affect the state's bargaining power.[11]

Beginning in 1979, the Indonesian state adopted a more activist role towards the transnational oil companies. During the late 1970s and the early 1980s an aggressive economic nationalist stance had emerged in the government and in civil society which favoured the nascent industry argument and the need to expand Pertamina's management functions.[12] There was presidential and ministerial support for it. The top decision-making elite - President Suharto, Ginandjar Kartasasmita, the Minister for the Promotion of Domestic Products, Minister of Industry Hartarto, and Research and Development Minister Habibie were the most vocal proponents of the nascent industry argument.[13] A number of forward-looking officials including Ir. Wijarso and O.R. Hutapea in the Ministry of Mines, Pertamina's President-Director Sumbono and Djack Zahar, the head of the Foreign Contractors Coordinating Body (BKKA) housed in Pertamina, also propagated this view.[14]

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[9] Douglas Bennette and Kenneth Sharpe, Transnational Corporations Versus the State: The Political Economy of the Mexican Auto Industry (Princeton: Princeton University Press, 1985), 84.

[10] Shephard, "Cigarette Industry," 105.

[11] Alfred Stepan, The State and Society (Princeton, N.J.: Princeton University Press, 1978), 238-39.

The economic nationalists in the state apparatus were more enthusiastic about hastening the process of indigenisation of the oil industry than local firms themselves. They believed that the state must bear the additional costs involved in increasing domestic participation in the oil industry. They asserted that lower revenues in the present would bring future gains to the local economy. The rhetorical rationale espoused by the government was to "meet the national aspirations of Indonesians to see the greatest possible national content in its economic life" which of course, primarily meant the interests of the domestic entrepreneurial class and the state decision-makers. They were not "... led by nationalist politicians voicing the old fears of neo-colonial domination but by administrators who shared with the leading military figures the belief that Indonesia was a potentially major power and should possess a concomitant industrial base."[15]

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[12] A seminar held by the participants of a seminar held by Lembannas (National Defense Institute) on the role of the natural oil and gas in national development came to the following conclusion. "Now Time to Give More Authority to Pertamina," The Indonesia Times, 6 November 1978.

[13] Since prominent officials and ministers with professional degrees such as Minister of Research and Development Habibie and Ginandjar Kartasasmita were arguing for import-substitution industrialisation, observors came to call them "economic nationalists" or "engineers" while preserving the epithet "technocrat" for those officials who had neo-classical liberal world-views.

[14] Paul Handley, Paul, "Who Said It Was Easy: It's a Hard Road to Indonesianization," Petroleum News, May 1985, 57.

As new orientations within the state apparatus emerge and new bargains have to be struck with transnationals, the state creates new institutional and legal structures to deal with transnational corporations and to implement its policies. Two presidential decrees were issued in 1980. Presidential decree Kepres 10 of January 1980 aimed to regulate the expenditures and management of state budget funds. A procurement guidance team was established under the aegis of the State Secretary to review all government contracts worth more than Rp 500 million (U.S. $800,000) for goods and services that the oil companies procured on Pertamina's behalf.[16] The aim was to centralise control in the tender and award of large government contracts. Chaired by the Minister/Secretary of State Sudharmono or the Minister of State Reform Sumarlin, it would review all contracts to ensure that the transnationals complied with government policies at competitive prices and promoted domestic products and services.

Kepres 14A, issued in March 1980, aimed to give domestic products and economically weak companies preference for government contracts.[17] All contracts for amounts up to $320,000 were reserved for local companies. For contracts that required larger capital investments there would be open tenders with priority for local firms or foreign firms that maximised local content. Foreign companies and economically strong Indonesian firms could not conduct trade. They had to appoint sole agents as their representatives.[18]

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[15] Ruth McVey, "The Materialisation of the Southeast Asian Entrepreneur," in Southeast Asian Capitalists ed. Ruth McVey, Studies on Southeast Asia, Southeast Asia Program (Ithaca, N.Y.: Cornell University Press, 1992), 24.

[16] U.S. Embassy, Indonesia's Petroleum Sector (Jakarta: U.S. Embassy, 1983), 55.

[17] The decree of 1979 was amended in 1980 by Presidential decrees nos. 14A of 1980 and 18 of 1981; Presidential decrees nos. 29 and 30 of 1984 defined an economically weak company.

The economically "strong" groups which included foreign companies and most local Chinese-owned companies, were to form joint ventures with "economically weak" firms and to transfer 51 percent equity to them within ten years. As long as the cost of doing without the services of the foreign firms is high, the rational state can be expected to continue to encourage linkages with transnationals. The Indonesian state's decision-makers realised that foreign investment was essential to keep abreast with new technological developments and that local companies would require a certain gestation period before they could replicate the transnationals' firm-specific functions and replace them. The state aimed to gradually reduce the cost of doing without the foreign presence. This legislation encouraged the growth of intermediaries, automatically increasing the costs of goods and services. But it also allowed would-be entrepreneurs with little capital and experience to begin the process of accumulating it.

Changing international conditions in the international oil market encouraged the pursuit of such a policy. The Iranian revolution led by Ayatollah Khomeini, in which the Shah was overthrown in December 1978, impeded the promise of a relative equilibrium in oil prices which were expected to stabilise at around US $15 per barrel in mid-1978. When the world oil market was deprived of Iran's normal supply of 5.3 million bpd, fears of severe shortages arose. The second critical circumstance was the Iraqi attack on Iran in September 1980. The Iranians successfully challenged this attack and blocked Iraq's access to the Gulf, which effectively cut off its oil exports. Thus world oil markets were deprived of the exports of two of the world's largest producers after Saudi Arabia. These two events caused tremendous fears of shortages despite the fact that other OPEC producers, especially Saudi Arabia, were able to cover the shortfalls. In response to these premonitions, prices on spot markets sky-rocketed.

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[18] U.S. Embassy, Indonesia's Petroleum Sector (Jakarta: U.S. Embassy, 1981), 69.

OPEC pricing behaviour was strongly influenced by the movement of the spot market during this period. So the price of oil rose from US $13 per barrel in mid-1978 to US $34 per barrel in 1981. In 1981 the most popular view was that OPEC countries would go on providing adequate oil to the world market to prevent shortages but that the price of oil would rise to US $60 per barrel, indeed, ultimately to US $100 per barrel because of the perception of uncertainty over the oil supplies that OPEC countries were willing to make available to important consuming countries.[19]

What immediate effect did the new structural conditions in the oil industry have on bargaining between the transnationals and host governments? In the short-term, as spot prices accelerated more quickly than official prices, a situation that host governments found unacceptable, the oil-producing countries reneged on their long-term preferential oil supply contracts to take advantage of ever-rising oil prices. These actions reinforced the bargaining "balance of power" model's expectation that host governments are unlikely to maintain contract sanctity with transnational corporations when changing conditions favour abrogation. Host governments did not as a general rule re-negotiate their upstream equity/producion-sharing contractual arrangements with the transnationals. Both the transnationals and host governments benefitted from the increased profits that rising oil prices brought. Massive budget surpluses gave host governments a new sense of freedom in charting out a more dirigiste role for themselves and for their state enterprises.

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[19] Peter R. Odell, Oil and World Power 8th ed. (Harmondsworth: Penguin Books, 1986), 249.

Governments have three ways of financing industrial development - rising tax revenues, borrowing from international public and private institutions, and domestic and foreign private capital. Rising tax revenues reduce the state's dependency on the latter two instruments and increase its sense of autonomy and confidence. Such a state is less constrained by external forces than it would be with a smaller surplus of tax revenues.

In 1980 the peak years for Indonesian oil and gas began. State revenues from oil and gas exports rose to US $15.7 billion in 1980 from US $9.8 billion in 1979, dispelling much of the crisis atmosphere that had pervaded Indonesia since the 1975 Pertamina crisis. Scores of new contracts were signed and total foreign corporate expenditures rose from US $1.96 billion in 1980 to US $3.06 billion in 1981; exploration budgets increased from US $0.67 billion to $1.11 billion.[20]

The structural transformations in the international oil industry and rapid oil exploration created the conditions for a more confident state policy. Indonesian policy-makers were now equipped with the resources to bear the increased costs that might emerge from a deepening of the import-substitution industrialisation effort with the aid of domestic goods and services and local firms, a primary aim of Replita IV (the Fourth Year Plan). The economic nationalists were convinced that they must seize the opportunity to utilise added oil revenues to achieve these objectives. In his 1982-83 draft budget Suharto called for a 34.5 percent increase in development expenditures to sustain "Indonesia's momentum of development."[21]

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[20] Petroleum News, October 1986, 9.

A more activist role for the state in the accumulation process and for public corporations was also outlined. In many developing countries, state enterprises remained by far the strongest enterprises with the capacity to bargain from a position of strength with transnationals. This view was re-affirmed by Minister of Industry Soehoed as he hastened to emphasise that public corporations did not aim to enter the market as competitors to private enterprise. "The path of development that promotes national enterprise by calling upon the public enterprise is probably the only path at the moment to accelerate development and to strengthen the structure of national industrial production."[22] Soeheod argued that state enterprises dominated the economy because their size enabled them to bargain with the transnationals and to ensure that they provided a detailed breakdown of the goods and services required in projects so that local companies could provide locally produced components, fixed and mobile capital assets and other support services. "It is not at this time intended that the public corporations pressure the private. Basically the state-owned corporation is based on the following principles, to develop vital sectors in which the capacity of private investors is limited."[23] By 1982 industrial projects to the tune of U.S.$ 2 billion were launched.

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[21] G. Vernon Hough, "Indonesia: Production Cuts Hit Development," Petroleum Economist, June 1982, 249.

[22] Ibid.

As the 1979 oil price increases came to Indonesia, a euphoria of immense proportions set in. A plethora of rising expectations began to surface, the natural culmination of windfall profits from the oil industry. Many new hopes and aspirations were expressed in different quarters. In the press it was asked whether the government would now seriously promote an indigenous entrepreneurial class.[24]

There was renewed disquiet about the losses to less privileged Indonesians from the industrialisation process. The market for goods consumed by well-to-do Indonesians and produced by majority-owned foreign joint ventures had become saturated in the mid-1970s. So the government took its first halting steps towards promoting non-oil exports with the November 1978 devaluation.[25] The devaluation, combined with high inflation in 1979, brought economic hardships to the ordinary wage-earner and the entrepreneur who served the local market.[26] Despite the ban on strikes and demonstrations since the establishment of the BA regime, workers took to the streets in thousands to give vent to their frustrations and demand higher wages.[27]

There were complaints that the Indonesian state was not safeguarding the needs and interests of domestic entrepreneurs against strong Chinese Indonesian entrepreneurs and foreign corporations. Merdeka urged the government to provide low-interest state bank loans to the weak Indonesian companies and to utilise increased oil revenues to bolster economically weak groups.[28] The regime was criticised for its dependence on foreign loans and there was a yearning for the day when the state would be free of its neo-colonial status.[29]

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[23] A.R. Soehoed, "Industrial Development During Replita III," Indonesian Quarterly 10, (1982), 55-6.

[24] Merdeka, 13 February 1979; Kompas, 5 March 1979; Indonesian Observor, 22 April 1979; Merdeka, 19 July 1980.

[25] Merdeka, 10 July 1979. Kompas, 30 April 1979. Pos Kota, 9 April 1979.

[26] Merdeka, 6 March 1980.

[27] Ibid.

In parliament three issues - bureaucratic corruption, improper accounting, and transfer pricing procedures adopted by transnational corporations - became subjects of critical debate in the late 1970s and early 1980s. The DPR Commission VI member Drs. Sudjoko alleged that the state was facing sustained losses because foreign companies were fiddling with their accounts, reducing their overall payments to the Indonesian state.[30] In its 1981 confidential survey the World Bank also drew attention to the combined effects of corruption and a lax regulatory environment that enabled domestic and foreign companies to negotiate their taxes.[31] A World Bank report in 1978 had noted that the tariff and taxation system pursued by the Indonesian government during Replita I and II had encouraged the growth of final assembly industries rather than intermediate and primary industries.[32] The Indonesian Commercial Newsletter noted that luxury-oriented industries had limited the multiplier effect.[33]

It is the state, as it dynamically transforms, that must re-adjust the alliance structure to accommodate a newly strengthened domestic entrepreneurial class and a more cognizant professional bureaucracy and middle class which seek a greater share of power and benefits from the accumulation process. The capitalist state must reconstitute the alliance since transnationals can no longer continue to be the exclusive beneficiaries of state policies that are generated to promote capitalist accumulation. This creates the potential for conflict between different capitals within the political arena which are often replayed within the state apparatus.

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[28] Merdeka, 19 April 1979.

[29] Ibid.

[30] Tempo, 21 April 1981.

[31] International Bank of Reconstruction and Development, Confidential Report, 1981.

[32] "An Examination of Growth in the Industrial Sector over Pelita I and II and Prospects for Pelita III," Indonesian Commercial Newsletter, 30 April 1979, 10.

[33] Ibid., 11-2.

The Indonesian state, in its Old and New Order configuration, had always presented itself as the facilitator of domestic capital. This is the tension for the state as a "relatively" autonomous actor. The Indonesian state could not maintain the degree of autonomy with respect to local capital that it had exercised a decade earlier because it had promoted a domestic entrepreneurial class. Indeed, to remain legitimate it had to promote it. But once local capital had emerged as a powerful contender for benefits from the system, the state was subject to constraints from local entrepreneurs.

The origins of the Indonesian entrepreneurial class have been intensively documented in the works of Richard Robison and Yoshihara Kunio.[34] Two fractions of the capitalist class are of interest to this study. The first generation of Chinese Indonesian entrepreneurs were mainly traders in the pre-war and early post-independence period. They turned manufacturers in the New Order period with the aid of foreign investors, an issue that I have discussed in greater detail in my discussion of the textile industry.

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[34] Richard Robison, Indonesia: Rise of Capital (North Sydney, Australia: Allen & Unwin, 1986); Yoshihara Kunio, The Rise of Ersatz Capitalism in South-East Asia (Singapore, Oxford, and New York: Oxford University Press, 1988).

Their businesses were organized along the principle of what the Chinese call shinyung (trustworthiness) and even the larger ones were family-based inter-locking conglomerates involved in a diversified range of products. Some of the larger ones had their own banks. The Chinese Indonesians needed an alliance with politicians under the Sukarno regime and with military and civilian bureaucrats under the Suharto regime to shield them against pribumi economic nationalism. They were economically strong pariah citizens lacking political power. The non-Chinese Indonesian entrepreneurs mainly derived their initial impetus to enter commerce and industry through political office or because of their connections to bureaucrats under the Sukarno and Suharto regimes. Ibnu Sutowo is Indonesia's most famous example of a first generation non-Chinese Indonesian who used his political power to enter the business world. During his tenure as President-Director of Pertamina Sutowo amassed a large personal fortune and came to head the still flourishing Nugra Santana group of companies.

The first generation of Chinese and non-Chinese Indonesians had received little or no professional training in business management. The second generation of entrepreneurs, whether the children of Chinese Indonesians or of government officials, were normally trained professionally with either business or other professional degrees obtained at Western universities. The family-based Chinese Indonesian conglomerate became a professionally-managed conglomerate. Many of them had become giants by industrialising country standards. Liem Sioe Liong controlled the largest conglomerate, which includes Indonesia's largest private bank, Bank Central Asia.

The second generation of non-Chinese Indonesians are mainly the children of well-to-do or powerful office-holders. Sutowo's son and Suharto's children are the most notorious examples of how the children of powerful state managers have emerged as the foremost entrepreneurs with "pribumi" ethnic backgrounds. Many of the new entrepreneurs owe their success to government largesse - the huge amounts of capital and contracts disbursed through state banks and state enterprises. In the upstream and downstream sectors of the oil industry, Suharto's sons and son-in-law were the main beneficiaries of utilising the legal framework for Indonesianisation.[35] If indeed state enterprises were to allow local capitalists to develop, then they would have to relinquish some of their tasks to local private firms. Pertamina, in its role as promoter of local capital, had to demonstrate how larger firms - public and private - were to make way for "economically weak Indonesians," by handing out oil marketing, LNG transportation, and the distribution of other products to Suharto's sons. They became Pertamina's sole agents. Suharto's oldest son, Sigid Harjojudanto who by the mid-1980s controlled thirty companies under the Bimantara umbrella, established a marketing company, Samudra Petroleum, to market Pertamina's oil internationally. Sigid was also awarded the contract to transport LNG to Korea with his brother-in-law Indra Rukman Kowara. In 1986 Pertamina gave PT Humpuss, a company owned by Suharto's youngest son, Hutomo Mandhala Putra Suharto, the sole distributorship for industrial methanol and purified terephlatic acid as a graduation present, a task that Pertamina could have performed on its own.[36] In 1987 Hutomo was awarded a twenty year transportation contract to ship

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[35] See also Wall Street Journal, 24-26 September 1986.

[36] Suara Pembaruan, 21 April 1987.

LNG to Taiwan.[37]

In the 1970s and particularly in the 1980s the institutional structure for entrepreneurial activity began to develop with great rapidity: associations, agencies, lobbies which differed from the previous dyadic relationships of patron-client networks. This gave entrepreneurs legitimate forums to express their concerns so that local entrepreneurs no longer needed to depend solely on political patronage to further their business interests.[38] Collective action enabled local and foreign entrepreneurs to influence government decision-making with much greater clout. A more professional business class had emerged with education and training in Western capitalist practices.

The government also began the process of assimilating Chinese Indonesians into the economy. The racist terms non-native/non-pribumi were dropped in favour of the more benign terminology that reflected Indonesia's changing realities - economically weak and economically strong groups. The Chinese had become more powerful than ever before and it was no longer possible to ignore their demands for political recognition as their economic power expanded. The melding of cultures and interests between Chinese and indigenous elites raised the question of whether in response to their demands for greater benefits the so-called "pribumi" Indonesians could continue to let off their steam by attacking indigenous Chinese whenever the regime was unable to withstand their pressures for greater benefits, as had been the case in the 1973 and 1980 anti-Chinese riots. It became official policy to inculcate respect for entrepreneurship and wealth and to repeatedly denounce any discrimination against the Chinese.

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[37] Ibid.

[38] Ruth McVey, "Materialization," 7-34.

Despite the emergence of a stronger entrepreneurial class, the push for rapid Indonesianisation in the oil supply and service industry came from an active executive and bureaucracy rather than from the capitalist class itself. The state remained the central arbiter of the interests of the domestic capitalist class and it would continue to determine the limits within which those interests would be articulated. Real decision-making power in Indonesia remained concentrated within a relatively small and highly centralised military and bureaucratic elite under the twin banners of the Indonesian Armed Forces and the government's ruling Golkar party.[39]

Section II

Over time, host governments can be expected to make concerted efforts to increase the bargaining power of domestic entrepreneurs and to force foreign oil companies to enhance local content in their operations. As in other manufacturing and natural resource industries, governments generally aim to increase domestic value-added and employment in the oil supply and service sector.[40] Host governments will in all likelihood continue to pressure transnationals for a greater share of benefits from their activities and for changes in their behavior.[41] To achieve these objectives the state imposes increasingly stringent performance requirements on transnationals.

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[39] Gordon R. Hein, "Indonesia in 1989: A Question of Openness," Asian Survey, 30 (February 1990), 221.

[40] Paul Hallwood, "Transnational Corporations and Industrial Diversification: The Case of the Offshore Oil-Supply Industry," Transnational Corporations 2 (February 1993), 91-109.

[41] Richard S. Newfarmer, "Multinationals and Marketplace Magic in the 1980s," in The Multinational Corporation in the 1980s ed. Charles P. Kindleberger and David B. Audretsch (Cambridge, Mass. and London: The MIT Press, 1983), 182.

For the Indonesian state, greater autonomy in the oil service sector had two dimensions. First, through Pertamina, it was directly involved in the production process. Second, it meant that the state exercised greater control over development decisions and created the structures to achieve those goals.[42] Petroleum News commented in 1985:

> In the past five years Indonesianization has become an important word for the service and supply industry. Originally used to describe the training of local workers to replace expat workers, Indonesianization now means that Indonesian products should replace imports, and Indonesian ownership should replace foreign equity. The reasons behind it are simple enough: national pride, a desire to spend oil dollars domestically, to employ more Indonesians and to develop technological capabilities that will outlast individual projects.[43]

The issue of equity ownership and its impact on host countries has been extensively debated in the literature on transnationals. It is generally believed that majority ownership gives local partners meaningful decision-making powers with regard to the local operation. For local partners, the profitability of the subsidiary has priority, whereas their foreign counterparts are primarily concerned with maximising global profitability. Majority ownership, an equity interest of 51 percent or more, gives the transnational a legal privilege to control the ownership rights it transfers and to determine the extent to which and the manner in which resources from the host economy will be utilised.[44] A common strategy that host governments have pursued to deal with the problem of denationalisation has been to prohibit foreign control of major manufacturing sectors by prohibiting foreign investment and by requiring majority control.[45]

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[42] Gary Gereffi, The Pharmaceutical Industry and Dependency in the Third World (Princeton: Princeton University Press, 1983), 159.

[43] Handley, "Who Said It Was Easy," 57.

[44] John H. Dunning, Transnational Corporations and the Growth of Services: Some Conceptual and Theoretical Issues (New York: United Nations Centre on Transnational Corporations, 1989), 13.

In industries where the state is primarily a regulator with respect to transnationals, host governments also climb a regulatory learning curve. From its experience in the manufacturing sector during its early years of bureaucratic ignorance, the Indonesian state had concluded that it was not enough to ask foreign investors to transfer their shares to Indonesians. As I will show in Chapter 11, the state had great difficulties in persuading the textile transnationals to transfer large blocks of shares to a few Indonesian partners. In the early 1980s when the textile transnationals were asked to relinquish control over 51 percent of their shares, they dispersed their equity publicly to retain effective control over the operations. Encarnation has commented on this phenomenon.[46]

In the early 1980s, the Indonesian state's regulators built upon the difficulties that they were experiencing in promoting Indonesianisation in other sectors because of their earlier regulatory omissions by forcing the issue of majority ownership in the oil service and supply sectors. Foreign investors were urged to allow their Indonesian partners to hold large blocks of equity so that the intent of the regulations was not lost in a wide dispersal of equity among many local investors with no management voice. As I will show in the case of the textile industry, this stipulation was never made in the manufacturing sector until the 1980s.

In a natural resource industry, the state's stake in controlling the transnationals' expenditures increases commensurate with its share of post-discovery costs. Indonesian government officials were agreed that since the state bore 85 percent of the costs of production, the state should control the foreign oil companies' expenditures. To borrow a sentence from Bennette and Sharpe: "The state learned."[47] As Migas and Pertamina state managers became more competent they demanded proper work programs and investment schedules.

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[45] Ibid.

[46] Dennis J. Encarnation, Dislodging Multinationals: India's Strategy in Comparative Perspective (Ithaca and London: Cornell University Press, 1989).

During the 1970s, many Third World states considered transfer-pricing to be the most significant area requiring regulation.[48] Transnationals use and manipulate internal market prices to conduct their international non-market transactions. For non-market transactions corporate managers can book any price for the good or service sold to their affiliates based on the global objectives of the parent firm. In the 1950s and 1960s, the foreign exchange controls imposed by many developing countries had been rendered meaningless by the transnationals' propensity to overcome these restrictions through transfer pricing. Transfer pricing became a significant concern to the critics of transnationals. This led to a spate of regulatory mechanisms to control transfer prices and a number of studies to determine its impact on host economies.[49] The supporters of internal markets, members of the Chicago school and orthodox neo-classical economists thought that transfer pricing was an efficient way for firms to conduct their transactions for goods and services for which no market price was available.

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[47] Bennette and Sharpe, Mexican Auto Industry, 262.

[48] Sanjaya Lall Multinationals, Technology, and Exports: Selected Papers (New York: St. Martin's Press, 1985), 78.

[49] In his investigation Constantine Vaistos found that in the 1960s transnationals operating in Columbia overpriced intra-firm transactions by 16 to 155 percent. Constantine Vaistos, Inter-country Income Distribution and Transnational Corporations (Oxford: Clarendon Press, 1974). In his 1973 study Lall also found overpricing in the pharmaceutical industry. Sanjaya Lall, "Transfer-Pricing by Multinational Manufacturing Firms," Oxford Bulletin of Economics and Statistics 35, no.3 (August 1973), 173-195.

Both host and home governments have sought to limit the transnationals' transfer pricing excesses to prevent adverse affects on tax revenues and balance of payments.[50] For instance, Section 482 of the U.S. Internal Revenue Code requires that all transfer prices should generally be established according to arm's length market values on any transaction between affiliates.[51]

Host governments commonly establish rules to enhance the bargaining power of buyers - local private firms and state enterprises - to "push suppliers closer to their floor price."[52] Through their state enterprises and government agencies, host states have succeeded in obtaining more competitive prices in many developing countries.[53] Governments also employ techniques to prevent transnationals from securing the monopolistic control exercised by technology suppliers such as requirements that the local firm buy all its inputs from the parent company, and grant-back clauses that enable the licensor to access the subsidiary's technological innovations without cost.[54]

Standard studies for budding multinational managers emphasise that actual or standard costs should be marked up to allow the selling subsidiary to "... realise a return on investment equal to that earned in the domestic market."[55] The mark up constitutes the "plus" in cost-plus transfer pricing which involves an arbitrarily and internally determined profit for the selling affiliate. Seeking to externalise the transnationals' prices and to obtain a market price for the inputs that transnationals provide to state enterprises and local firms, the de-mystified host government no longer wishes to accept the cost-plus method for the calculation of the transnationals' expenditures. Host governments want a break-down of costs.[56]

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[50] Wagdy M. Abdallah, International Transfer Pricing Policies: Decision-Making Guidelines for Multinational Corporations (New York: Quorum Books, 1989), 20.

[51] Ibid., 33.

[52] UNCTC, Transnationals Corporations in World Development: Trends and Prospects (New York: United Nations Centre on Transnational Corporations, 1988), 184.

[53] Ibid.; see also Encarnation, Dislodging Multinationals.

[54] UNCTC, Trends and Prospects, 184.

Current textbook advice to multinational managers is that they should set transfer-prices for goods and services in a range that foreign governments will find reasonable. Exceptionally high prices cause conflicts between host government and transnationals because of the negative balance of payments consequences that the outflow of profits to the foreign companies' affiliates engender.[57] Host governments seek to ensure that the long-term cash or fund outflows, such as dividends, royalties, and especially intra-company pricing manipulation, do not exceed significantly the value of goods, services, funds, or cash inflows.

Internalisation theorists such as Rugman, who has provided a rigorous theoretical critique of the arguments raised by the critics of the transnational corporations' transfer pricing practices, have argued that transnationals create transfer prices in response to market imperfections which are the product of government policy. They argue that the best way to eliminate transfer pricing is to harmonise different national tax rates and to eliminate exchange-controls instead of introducing new controls. Such arguments are based on the mistaken assumption that if governments did not create market imperfections there would be no transnationalisation of the firm.

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[55] See Abdallah, Transfer Pricing, 55; Richard J. Nagy, "Transfer Price Accounts for MNEs," Management Accounting (January 1978), 35.

[56] Abdallah, Transfer Pricing, 22.

[57] Ibid.

There is no question that controls on foreign exchange, profit repatriation and prices, weak currencies, and an enforcement of the use of local firms does create an incentive for transfer pricing in many developing countries. But transnationals emerge because of the absence of arm's length prices in external markets and the advantages that transnationals derive from such a state of affairs. It is not market relationships but power relationships between host governments and transnationals that determine the extent to which the host state will successfully erode the transnationals' internal markets and their ability to indulge in transfer-pricing. Jenkins argues that approaches to transfer pricing which seek to restore market prices are misplaced.[58] But how else, if not through controls and attempts to establish arm's-length prices, however imperfect, will host governments ensure that they and their local entrepreneurs are not paying higher prices than necessary for the services of transnationals?

Even if exploitation cannot be empirically measured "we cannot ignore the fact that the sense of being exploited is one of the powerful reasons for much hostility towards foreign investment."[59] States are bound to be sceptical because firms are inclined to maximise their global profits and to cheat within the confines of "legally acceptable" boundaries.[60] The Indonesian state sought to ensure that the transnationals did not derive "undue" benefits through inter-affiliate trade and service-exchanges in internal markets.

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[58] Rhys Jenkins, Transnational Corporations and Uneven Development: The Internationalisation of Capital and the Third World (London: Methuen, 1987), 119-120.

[59] Edith T. Penrose, The Growth of Firms, Middle East Oil and Other Essays (London: Frank Cass, 1971), 103.

The new and stringent regulatory environment was to be implemented by three state agencies - the Directorate General of Oil and Gas (Migas), housed in the Ministry of Mines and Energy, the Foreign Contractors Coordinating Body (BKKA), a sub-directorate housed in Pertamina, and the State Secretariat (Sekneg) to oversee the work programs of the foreign oil contractors. The BKKA's task was to monitor and coordinate the upstream activities of the transnationals. After the oil company had won a bid its investment plan would be reviewed and amended by Pertamina, approved by Pertamina's President-Director, and for investments exceeding Rp. 500 million,[61] clinched by Sekneg's procurement guidance team. MIGAS was responsible for the final approval of investments below that sum. These agencies had become power centres of significance.

Migas had supervisory authority over the contract-of-work companies - Caltex and Stanvac. It also oversaw Pertamina. It licensed companies to operate in the petroleum sector, enforced safety and environmental regulations and maintained statistics. It had major decision-making authority in all petroleum matters including pricing, personnel, and production.

MIGAS determined when Indonesian firms could provide a good or service independently. It established time-tables to phase out foreign oil service companies from the list of approved bidders; closed off sectors of the industry as they became saturated; omitted the names of noncompliant companies from its list of approved bidders. The BKKA and the State Secretariat would also examine corporate proposals to ensure conformance.[62]

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[60] Ibid.

[61] Following the 1983 devaluation this sum amounted to about $500,000.

Pertamina had become a vertically integrated company with assets in exploration, production, refining, transportation and marketing. By 1985 it would become self-sufficient in refining capacity.[63] It owned and operated all Indonesia's refineries, domestic distribution facilities, a fleet of tankers and other vessels and an aviation service. In 1981 it supervised 31 foreign oil producing companies and over 200 service companies. Pertamina had twenty-two joint venture companies and six subsidiaries which had been were established under Sutowo's aegis. In the oil supply and service industry Pertamina had several joint ventures and subsidiaries. It had a drilling joint venture with Dresser Magcobar; several construction joint ventures with foreign companies including P.T. Nippon Steel Construction, Brown and Root; an engineering joint ventures with Patra Vickers; and several others in insurance, pipeline construction, and equipment fabrication.

The new decrees gave teeth to the power that Pertamina had only legally enjoyed under the production-sharing contracts. For the first time, the BKKA, which had become a sophisticated bureaucratic agency, would now exercise real management and control over the industry. As the Indonesian state became more activist, it also increased the number of agencies involved in regulating the oil supply and service industry. For the first time, the BKPM, which had since 1967 gained experience in regulating local content, equity transfers, and entry barriers in the general manufacturing sector and which had previously been excluded from the oil industry, became involved in restricting the entry of foreign firms in the oil service and supply sector. In 1985 the BKPM came to be headed by no less a figure than Ginandjar Kartasasmita, who as the Minister for the Promotion of Domestic Products played an active part in defending import-substitution industrialisation, even if it was generated by foreign firms and even if it involved high costs. Although SEKNEG was not familiar with the industry, under the leadership of State Secretary Sudharmono and the Minister for the Promotion of Domestic Products, it was an aggressive defender of the nationalist line. The BKKA would judge the proposals of foreign firms and protect through non-tariff barriers, the government's priority list (Daftar Scala Prioritas), which limited competition.

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[62] U.S. Embassy, Indonesia's Petroleum Sector (Jakarta: U.S. Embassy, 1983), 54.
[63] Petroleum News, October 1986, 11.

But the dependent capitalist state is relatively, not completely autonomous. While it has interests of its own, it remains subject to pressures from other actors and internal and external structures that impinge on the policy strategies that it can pursue.[64] Therefore, the capitalist state is unlikely to put in place policies that undermine the investment climate for foreign investment.[65] Although the Indonesian state espoused these goals - to expand control over national expenditures and to promote an entrepreneurial class - it did so within the parameters of the continued role of foreign capital in the economy. As the succeeding encounters will show, the state could implement these decisions but it was also constrained by the limits that transnationals can impose on the accumulation process.

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[64] Bennette and Sharpe, Mexican Auto Industry, 250.
[65] Ibid., 250-51.

The BKKA requested the foreign oil companies to cooperate in promoting state goals.[66] To retain its legitimacy the capitalist state must ask foreign capital to participate in promoting its social project. Moran argues that through such participation transnationals can avert political risk in host countries.[67] But this has its own contradictions for transnationals. They become the subject of greater ridicule at home since they are seen to be transferring jobs to foreigners.[68]

The bureaucracy no longer bargained with the transnationals from a position of ignorance.[69] Pertamina and the Ministry had become sophisticated bureaucratic agencies with their own team of qualified engineers, geologists, accountants and lawyers.[70] They began to exercise their theoretical powers more fully. They now had the expertise to analyse the legitimacy of the transnationals work plans and to ensure that expenditures and work plans coincided. They used the "mechanism of comparison" to cross-check the companies' expenditures, equipment prices, and services. The aim was to erode the internal market prices used by the large international firm so that competitive prices could be obtained for the goods and services that the oil companies provided. International consulting firms such as White and Case, Arthur D. Little, and Price and Waterhouse were enlisted so that the government could achieve independent evaluations of the geological and economic costs involved in various projects.

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[66] BKKA circular, letter no. 5593/UM/BKKA/79, 29 October 1979.

[67] T.H. Moran, "International Political Risk Assessment, Corporate Planning, and Strategies to Offset Political Risk," in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. T.H. Moran (Lexington, Mass.: Lexington Books, D.C. Heath, 1985), 113.

[68] Ibid.

[69] See Theodore H. Moran, Multinationals and the Politics of Dependence: Copper in Chile (Princeton: Princeton University Press, 1974), 167, 193-97; William A. Stoever, Renegotiations in International Business Transactions (Lexington, M.A.: D.C. Heath, 1981), 4-5; Howard Lax, States and Companies, 160.

[70] The following discussion is based on a number of interviews conducted from December 1986 to January 1988.

The bureaucracy also has interests of its own. It seeks to extend its power and control over the industry. In response to the 1977 changes in the production-sharing contract, Pertamina intervened in the decision of commerciality, that is whether the transnationals had discovered oil in sufficient quantities to justify the economics of producing it for commercial purposes. It introduced the 50 percent rule-of-thumb measure as the basis to determine an appropriate share for revenues for the state from an specific contract area. The oil companies could only develop a field for commercial production after expending exploration costs if they could promise the government at least 50 percent of the production from a field. Otherwise, they could develop the field and recover their costs. Similarly, the 1977 incentives for new oil and secondary and tertiary recovery were also granted on the basis of the 50 percent rule.

Pertamina also intervened in determining the geological basis for distinguishing primary fields from secondary and tertiary recovery fields. The costs of producing a barrel of oil through secondary recovery were astronomically higher, approximately 10-25 times or more, than the cost of producing a barrel through primary techniques. For every additional barrel of oil that was defined as secondary rather than primary production, the oil company could extract rich pre-tax profits in cost recovery.

The government's new activist policy stance allowed Pertamina to intervene directly in the internal decisions of the subsidiary and to erode the transnationals' autonomy and the split-ownership principle which had given them the freedom to manage and control their operations without much interference from Pertamina. It interpreted Kepres 14A to mean that all imports could only be sourced via Indonesian agents. It became imperative for sales companies to appoint local suppliers for on-the-spot marketing and after-sales service. Transnationals could no longer resist hiring Indonesians, as they had done in the past. The 1981 U.S. Embassy petroleum report emphasised the ever-increasing importance for U.S. companies to implement training and upgrading programs.[71] Now the BKKA ordered the transnationals to appoint senior vice-presidents and it reversed the transnationals' internal decisions regarding issues such as employee benefit packages. These technocrats began to use their expertise to maximise Indonesia's present and future "just returns" from the oil industry and to foster an enlarged pool of capital so that Indonesians would eventually own more enterprises in the future.

This new show of power by the agencies of the Indonesian state perturbed the transnationals. Their freedom was suddenly curtailed and operational control was being wrested from them. They could not invoke contract sanctity since they had legally ceded their management prerogatives to Pertamina under the production-sharing contracts. They argued that Pertamina was undermining the essence of the production-sharing contract, a business contract, that had promised them autonomy in managing their operations. The original bargain had obsolesced.

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[71] U.S. Embassy, Indonesia's Petroleum Sector (Jakarta: U.S. Embassy, 1981), 68-9.

As the years wore on the criteria of price, availability, and relative quality in the government decision to award contracts had to be balanced with its preference for domestic sourcing and content. The Procurement Guidance Team began to review cost-plus contracts and demanded that they be re-negotiated on a fixed price basis. It began to bypass the foreign oil companies by negotiating directly with suppliers and sub-contractors to obtain the best price and to ensure that there was the maximum utilisation of local content. Foreign firms that had won tenders were asked to change their local suppliers, sub-contractors, or partners. The government and Pertamina continued to justify these policies and procedures on the grounds that it was the government that ultimately bore 85 percent of any increased costs. The contractors countered that they were expected to assume 15 percent of the burden of these policies and the cost of project details that were the natural product of bureaucratic intervention.[72] They began to automatically over-invoice their costs by 15 to 20 percent.[73]

Section III

The first major bargain that the newly activist state negotiated was the equity-sharing bargain between the Indonesian government and the contract-of-work companies,

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[72] Ibid, 69.

[73] Corporate executive, major oil company, interview by author, Jakarta, 6 March 1987.

Caltex and Stanvac. Their contracts were to expire on 27 November 1983.[74] Formal negotiations began in 1982. Between 1977 and 1982, Caltex's share of total Indonesian production ranged between 48 and 36.2 percent; Stanvac's share approximated 2-3 percent.[75] Caltex had renegotiated its thirty-year contract-of-work in 1971 so that when it expired in 1983, the contract would automatically become a production-sharing contract. Stanvac had not been so farsighted and in the government's eyes it was dispensable. Stanvac's repeated pleas for renegotiation were ignored as the government abruptly terminated its contract. But with zest the government awaited the fruition of Caltex's grandiose enhanced oil recovery program.

On 26 November 1983, Caltex and the government agreed that the government would receive 88 percent of the production from Caltex's Minas and Duri fields instead of the usual 85 percent that characterised the production-sharing contract.[76] The government's real equity split would rise to 91 percent after the first five years of production when the government would receive Caltex's domestic contribution at 20 cents a barrel.[77] Caltex would continue to make its $3 billion investment in secondary and tertiary recovery.[78] Caltex obtained the incentives that it desired. For five years all crude oil produced and saved in the area would be considered enhanced recovery production for which Caltex would receive the 1977 incentives - a 20 percent investment credit, the market value for its contribution to the domestic market, and accelerated depreciation. The negotiation was hailed as a victory for the government.

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[74] Far Eastern Economic Review, 8 December 1983, 10.
[75] Indonesian Commercial Newsletter, 5 December 1983, 31.
[76] Far Eastern Economic Review, 8 December 1983, 10.
[77] The Jakarta Post, 26 December 1983.
[78] Ibid.

The Caltex case is a good illustration of the bargaining/dependency combination discussed in Chapter 1. The state can be in a dependency relationship with transnationals even when it has a greater capacity to extract concessions. While the bargain may obsolesce as the state moves to change the original terms of the agreement, transnationals use their "... moment of strength to shield themselves against the more extreme degrees of exposure."[79] Transnationals shield themselves from the costs of "irresponsible nationalism."[80] The Indonesian state did behave in the classic fashion described in the bargaining "balance of power" model: the original contract obsolesced and the state demanded and obtained a higher share of rent than the original contract of 1971 had envisaged. But the state did not concede to the more extreme demands of Indonesian economic nationalists for whom the "exploitative" connotations of Caltex's operations would only end if the more extreme measures of contract termination or a major reduction in its profits was achieved.

The bargain with Caltex was a traditional revenue-sharing one. But it also had a new facet, in which Pertamina's bureaucrats expressed a desire to takeover and run Caltex's old fields. There were no differences within the state apparatus about changing the original bargain or about pursuing a policy of economic nationalism which militated against allowing Caltex to obtain the normal 85/15 production-sharing split. But there were differences of opinion within the state apparatus about the technical capacities of Pertamina and the supply price that should be extracted from Caltex.

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[79] T.H. Moran, "Conclusions and Policy Implications," in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. T.H. Moran. (Lexington, Mass.: Lexington Books, D.C. Heath, 1985), 153.

[80] Theodore H. Moran, "Does the World Bank Have a Role in the Oil and Gas Business," Columbia Journal of World Business 17 (1985), 51; and Theodore H. Moran, "Transnational Strategies of Protection and Defense by Multinational Corporations: Spreading the Risk and Raising the Cost for Nationalization in Natural Resources," International Organization 27 (Spring 1973), 289-302.

Further, the relative power of the ministries and agencies involved in the formulation and implementation of policy and the relationships among them affect the state's ability to carry out its policies. Bureaucratic conflict within the state not only makes unified action more difficult but allows corporations to play off one ministry against another. There may also be divisions or factions within ministries or bureaucratic agencies.[81] The state was fragmented in its approach about how the national interest could be best served. There were various interpretations and interests within the state apparatus. The policy's adoption depended on an intricate struggle. The technocrats in the ministry of mines were "reasonable" and "pragmatic". They believed in maximising the state's revenues without jeopardising the viability of the industry. Their articulation of the national interest was based on several assumptions: the oil companies were essential to the continued viability of the industry and Pertamina lacked the resources to operate the two areas with the same care and attention that the oil companies would expend. The BKKA's bureaucrats were keenly interested in increasing their control over the oil industry and in trying their hand at running the old areas themselves. The original bargain did obsolesce but not to the satisfaction of the BKKA bureaucrats. They were bureaucrats of the "frustrated nationalist ilk" in Evans' phraseology,[82] or in Adler's terminology, "ideological guerillas."[83] That is, when state managers develop interests of their own and when they have increased technical capacities they become increasingly frustrated by the foreign dominance of an industry.

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[81] Evans, Rueschemeyer, and Skocpol, "More Adequate Understanding," 354.

These technical experts were also operating within the context of a regime whose ideology legitimised this approach. The BKKA was able to act because of the regime's general commitment to a deepening of import-substitution industrialisation. It had received a mandate to control the oil companies' expenditures. The new activist stance since 1979 lent ideological support to this view. Rising oil prices in 1979-81 period cemented this view. The oil boom had brought massive exploration and production activity to Indonesia. It also gave Pertamina technocrats greater confidence about running a greater part of the industry on their own. Jack Zahar, BKKA's chief, was convinced that Pertamina could and should run the old fields in the Caltex contract area when its contract-of-work terminated in 1983. This would give Pertamina immense power.

The bargaining "balance of power" model expects that when the foreign transnational is seen to be making exorbitant profits, then domestic forces will demand an increased share of those profits in the name of justice and fairness. As soon as the ink has dried on a contract there will be forces ready to re-negotiate it in the host country's favour. This is particularly true when the transnational controls a large share of an industry on the "commanding heights" of the economy. Moran has noted that the foreign company will describe the demands of the state and other economic nationalists in the domestic arena as irrational, emotional, and purely political.[84] The firm will invoke contract sanctity. But the state will successfully force the transnational to accept reduced profits, especially when the firm has sunken investments and can be held hostage. Some scholars argue that there is a rational basis for a host government's demand for a larger share of revenues even if this demand is couched in emotive rhetoric.[85]

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[82] Peter B. Evans, "State, Capital, and the Transformation of Dependence: The Brazilian Computer Case," World Development 14 (1986), 803.

[83] Emmanuel Adler, " 'Ideological Guerillas' and the Quest for Technological Autonomy: Brazil's Domestic Computer Industry," International Organization 40 (1986), 673-705.

Within and without Indonesian government circles there was a strong perception that Caltex had reaped the benefits from the "bonanza" for far too long and that the government was entitled to a larger share of rent. For three successive years, 1976-1978, the Petroleum Intelligence Weekly reported that Caltex made 70% of its worldwide profits in Indonesia.[86] In July 1982 the Jurnal Ekuin reported that throughout the preceding decade, the government's share of revenue had amounted to only 5.58 to 25.27 percent of Caltex's total production because the company had recovered large amounts in cost recovery.[87]

Professor Ir. Johannas, a renowned national figure and the rector of Gajahmada University, an isolated island of radicalism in authoritarian Indonesia, invoked patriotism to justify national control of the gigantic and proven Minas fields to be exploited on behalf of the Indonesian people by Pertamina.[88] In Parliament, Rachmat Witular, the Chairperson of the Commission of VI, the parliamentary committee that scrutinised mining matters, demanded that Pertamina, which now had developed the expertise to run the oil industry, should terminate Caltex's contract and operate the area on its own.[89] On 28 June 1982 he told Judo Sumbono, Pertamina's President Director, that the state had unwisely extended Caltex's contract in 1971 when it had few bargaining resources.[90]

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[84] Moran, Politics of Dependence, 168.

[85] Ibid., 169.

[86] High-ranking government official, interview by author, Jakarta, 7 April 1987.

[87] Mansur Amin, "Kontrak Karya Dengan Caltex, Seakan Hadapi 'Buah Simalakama'," Jurnal Ekuin, 5 July 1982.

As I discussed in greater detail in the last chapter, the transnational will evoke contract sanctity to justify the prolongation of its original contract terms and will condemn the host government for irrational behaviour. Invoking contract sanctity, the "business" nature of the production-sharing contract, Caltex denounced such demands as irrational and the product of politics.[91] Caltex executives protested, though they knew that they protested too much. Adelman reminds us that in international mineral agreements contracts have no force.[92] In 1968 OPEC governments had resolved that American-style contracts, those paper promises, would not curb them. They went on to provide ample evidence of their intentions in the Tehran-Tripoli agreements, the 1973 Arab embargo, and in numerous solo performances.

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[88] "The Future Contract With Caltex," Business News, 26 August 1982.

[89] Kompas, 25 August 1982.

[90] Ibid.

[91] "Caltex's Oil Contract," Merdeka, 26 August 1982.

[92] Morris A. Adelman, "The Multinationals in the World Oil Market: The 1970s and 1980s," in The Multinational Corporation in the 1980s ed. Charles P. Kindleberger and David B. Audretsch (Cambridge, Mass. and London: The MIT Press, 1983), 123-138.

On 26 August 1982 Merdeka, Indonesia's radical economic nationalist newspaper rebutted Caltex's sentiments with the argument that the Indonesian government's demands had an economic and technical basis.[93] Judo Sumbono himself did not disagree with Witular's contention. Indeed in Pertamina, Sumbono and the Foreign Contractors Coordinating Body headed by Jack Zahar had formed a strong anti-Caltex coalition.[94] They sought to limit Caltex's profits to the minimum.[95] In October 1982, Brigadier-General Sumbono announced a three-tier system under which Caltex's profits would be reduced to 5 percent of equity oil after development and production costs were deducted because the company produced more than 250,000 bpd.[96]

The interest of the transnationals lies in maximising their overall profitability and the extent of their world-wide reserves. They internalise their technological advantages, use their own personnel, and market their products as they see fit. To reduce their overall tax burden and their costs, to make their host and home governments bear the brunt of operating costs, and to enhance their profitability transnationals use a number of options to compute their taxes and the practice of transfer pricing.[97] In his comparison of U.S. domestic firms and transnational firms Cohen found that transnationalisation enabled the latter to achieve greater financial stability in their operations compared to the former.[98]

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[93] "Caltex's Oil Contract," Merdeka, 26 August 1982.

[94] Two high-ranking government officials, interviews by author, Jakarta, 7 April 1987 and 2 January 1987.

[95] Corporate lawyer, major oil company, interview by author, Jakarta, 17 February 1987.

[96] Financial Times (Frankfurt Edition), 5 October 1982. Also see, "Caltex Accepts Basic Provisions of New Contract," Indonesian Commercial Newsletter, 19 October 1982, 36 and "Production-Sharing Contractors Dominating Indonesia's Oil Industry," Indonesian Commercial Newsletter, 5 December 1983, 32.

[97] Celeste K. Gaspari, "Foreign Market Operations and Domestic Market Power," in The Multinational Corporation in the 1980s ed. Charles P. Kindleberger and David B. Audretsch (Cambridge, Mass. and London: The MIT Press, 1983), 79.

Secondary recovery provides the transnational with an occasion to inflate operating costs. Huge benefits can be reaped by classifying primary oil production as secondary production.[99] The cost of producing a barrel of oil through primary techniques was less than a US dollar for Duri oil. But the going rate for secondary recovery production was a steep US $10-25.[100] Caltex could reap tremendous profits if it classified a larger proportion of oil as secondary recovery production.[101]

Only a preliminary computer generated simulation model serves to distinguish between primary and secondary recovery.[102] A specified amount of production below a certain base line is classified as primary recovery and anything above that base line is treated as oil produced through secondary recovery. Djack Zahar, the head of the B.K.K.A., a geologist by training, sceptically questioned the validity of Caltex's geological assumptions. He argued that the company was depressing the amount of oil that could be gained from primary recovery and inflating the amount of oil that would accrue from secondary and tertiary recovery. As one of Caltex's executives admitted, it was at Zahar's insistence that Caltex had been forced to distinguish between old areas, fields from which oil was produced through primary techniques, and the new areas in which secondary and tertiary recovery techniques were to be employed.[103] Zahar opened the negotiations in a letter dated 26 January 1982, adopting an approach that Caltex found "cold" and "aggressive" compared to the calm manner in which the 1971 contract had been negotiated.[104]

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[98] Benjamin Cohen, "Foreign Investment by US Corporations as a Way of Reducing Risk," Economic Growth Center, Discussion Paper No. 151 (Yale: Yale University, 1972) cited in ibid.

[99] High-ranking government accountant, interview by author, Jakarta, 20 January 1987. For a description of the key components of secondary recovery contracts and incentives available to transnationals see Perusuhaan Pertambangan Minyak Dan Gas Bumi Nasional(Pertamina), Secondary Recovery Contract with Mainline Resources, 10 November 1982, 6, 17, 18, 21-22.

[100] Government geologist, interview by author, Jakarta, 20 January 1987.

[101] High-ranking government accountant, interview by author, Jakarta, 20 January 1987.

[102] Piet Haryono, President Director, Perusahaan Pertambangan dan Gas Bumi Negara(Pertamina), Letter to P.T. Caltex Pacific Indonesia, Re: Tentative Plan For the Study - Minas Enhanced Recovery Project, Letter no. 1001/DR/DU/77, 15 October 1977.

> At every step, we were opposed by Judo Sumbono and Jack Zahar who did not want us to get allowances. Jack Zahar was a tough negotiator. In many ways he was right. He urged the government not to allow the 1971 negotiation to stand. Zahar was also opposed to giving Caltex 15 percent of production. He even gained the respect of "reasonable" government officials, officials who did not want to terminate Caltex's activities. We countered his argument for re-negotiation based on the argument that the production-sharing agreement was a business agreement. We also warned that if Caltex did not ensure that for every barrel of oil produced there was a barrel in the ground, then the government could expect very little production in future years.[105]

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[103] Corporate lawyer, major oil company, interview by author, Jakarta, 17 February 1987.

[104] Haroen al-Rasjid, Chairman, Managing Board, P.T. Caltex Pacific Indonesia, letter to Ir. D. Zahar, Head of the Foreign Contractors Coordinating Body, Re: Amendment to the Pertamina and P.T. Caltex Pacific Indonesia Production-Sharing Contract, Letter no.303, 3 June 1982.

[105] Corporate lawyer, major oil company, interview by author, Jakarta, 17 February 1987.

With anticipation Pertamina bureaucrats awaited a tough response from Suharto.[106] In a memorandum to the Minister of Mines and Energy Subroto, Suharto responded with alacrity to the resentment expressed in the press, in Pertamina, and among some Ministry officials about the company's exorbitant profits. He reasoned that the government had just grounds to renegotiate Caltex's production-sharing contract and demand a greater share of the rent. An 85:15 split was no longer acceptable. Suharto noted that Caltex had exploited the government's weak bargaining position by deliberately renegotiating in 1971 a contract which was due to expire in 1983 when the price of oil had been a mere US $1.75 per barrel and the government sorely needed "development funds."[107] Soeharto declared that the government should set its sights at a 95:5 or a 97.5:2.5 split.[108]

There was a strong sense among state managers, and there was general agreement among them - Suharto, Subroto, Wijarso, Sumbono and Djack Zahar - that Caltex had taken advantage of the government's weakness in the early 1970s by renegotiating its contract early. This sense of frustration produced greater intolerance against the company.

> It may pay a firm in the short run to take advantage of the venality or ignorance of host [governments] and obtain agreements that contain provisions which are manifestly indefensible from the point of view of the countries' welfare, or to resist reasonable changes in such agreements when conditions have changed. In the longer run however, such

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[106] Corporate lawyer, major oil company, interview by author, Jakarta, 17 February 1987. High-ranking government official, interview by author, Jakarta, 7 April 1987.

[107] Memorandum from President Suharto, Republic of Indonesia, Memorandum, Re: Renegotiation of Caltex 1983 Contract, n.d.

[108] Ibid.

> "exploitation" may give rise to resentment that will lead new or better-informed governments to take severe, and perhaps in their turn, unreasonable, action against the firm.[109]

Moran argues that corporations must be prepared to bring more resources to the service of the host country as there is an increase in "domestic capacities."[110] It was taken for granted by the Indonesian state's decision-makers and by Caltex, that with the passage of time, Caltex's 1971 contract which would have given the state only 70 percent of the revenues, had obsolesced. The radical restructuring in the revenue-sharing arrangements wrought by the OPEC revolution had settled that issue. The subject of negotiation was whether the state could extract a higher share of rent above the 85 percent base line that had become the accepted norm under the production-sharing contract without jeopardising the absolute revenues that it might gain from the project.

The state is not a monolithic or coherent actor. Various societal groups and government agencies will have different objectives relative to foreign investment and the domestic political process affects the translation of potential power into control over outcomes.[111] While the bureaucracy in Pertamina had hoped that Suharto would allow it to manage Caltex's operations single-handedly or at least reduce its profits considerably, Suharto and the Ministry of Mines bureaucracy, the Minister of Mines, and the Director General of Migas, Ir. Wijarso did not wish to terminate Caltex's operations.[112] In their view, Caltex's presence was essential to the continued viability of the Indonesian oil industry.

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[109] Edith T. Penrose, The Large International Firm in Developing Countries: The International Petroleum Industry (London: Allen and Unwin, 1968), 267.

[110] Moran argues that companies must be willing to commit more resources to the national arena when the balance of power is to their disadvantage. Moran, Politics of Dependence, 223.

[111] Dennis Encarnation and Louis T. Wells Jr., "Sovereignty en Garde: Negotiating with Foreign Investors," International Organization 39 (Winter 1985), 47-8.

Why did Suharto accept the 88:12 split? When the transnational brings all three of its primary firm-specific advantages to bear at the time that it is promising a new commitment or or is even in the process of making one, the balance of power shifts in its favour. According to the theory of oligopolistic advantage, the basis of the work of Hymer, Kindleberger, and Richard Caves, the transnational controls a package of intangible and tangible assets with features that cannot be easily imitated by potential rivals.[113] This gives the firm a monopolistic advantage over other firms and enables it to establish barriers to entry. An important intangible asset that an incumbent firm has over a newcomer is its familiarity with and its ability to exploit domestic political processes. First-mover advantages, such as accumulated experience of the geological terrain of a particular field, cannot be easily replaced.[114]

When the foreign firm's contribution to the host country takes the form of a continued stream of innovations attached to proprietary knowledge, then nationalisation, the less extreme measure of contract termination, or even the extraction of higher profits may constitute a real loss to the host country.[115] Transnationals spend huge amounts of money on research and development which gives the host state access to state-of-the art-technology, essential for more difficult kinds of exploration.[116] Comparing U.S. domestic and transnational firms Severn and Laurence concluded that transnationals achieved higher profits and tended to spend more on research and development.[117] It is these advantages that the host government covets. Indeed since the 1970s, as the oil transnationals gradually lost control over pricing and marketing, they concentrated their efforts on developing new technologies so that they could continue to access this firm-specific advantage with respect to host states, national oil companies, and local firms. Particularly since the Tehran-Tripoli agreements of 1971, contract sanctity had proven itself to be a useless weapon for transnationals in negotiations with host states. The oil transnationals had to remain at the leading edge of technological innovation.

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[112] High-ranking government official, interview by author, 15 September 1986.

[113] See for instance, Stephen Hymer, "The Efficiency (Contradictions) of Multinational Corporations," American Economic Review 60 (May 1970), 441; Charles P. Kindleberger, American Business Abroad: Six Lectures on Direct Investment (New Haven and London: Yale University Press, 1969); Richard Caves, Multinational Enterprise and Economic Analysis (Cambridge: Cambridge University Press, 1982).

[114] Bruce Kogut, "Foreign Direct Investment as a Sequential Process," in The Multinational Corporation in the 1980s ed. Charles P. Kindleberger and David B. Audretsch (Cambridge, Mass. and London: The MIT Press, 1983), 43.

Kobrin has argued, that in the oil industry the "technological intensity" of secondary and tertiary recovery has caused the bargaining "balance of power" to shift in favour of the transnational.[118] Further, like host governments, transnationals also climb a learning curve. Corporate strategists determine where the highest barriers to entry exist and whether those barriers can surmount the host state's intrusions. "There are tens of billions of dollars riding on the answer to this question."[119] Transnationals sequence their investments to optimise their bargaining resources to combat nationalist attacks.[120] They postpone new investments until governments are expected to demand adjustments in their contractual terms, that is when their contract is likely to be terminated or re-negotiated. Then they tend to bring their package of unique assets to bear, neutralising the bargaining resources that a host government typically derives from holding a transnational hostage because of its sunken investments. As Encarnation has shown in the Indian case, transnationals use their technological bargaining card whenever the state and domestic entrepreneurs bring their increased bargaining resources to bear.[121]

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[115] Ibid.

[116] A. Severn and M. Laurence, "Direct Investment, Research Intensity, and Profitability," Division of International Finance Discussion Paper no.30 (Board of Governors of the Federal Reserve System, 31 May 1973) cited in K. Celeste Gaspari, "Foreign Market Operations," 79.

[117] Ibid.

[118] Stephen Kobrin, "Testing the Bargaining Hypothesis in the Manufacturing Sector in Developing Countries," International Organization 41 (Autumn 1987), 613.

Moran observes that there are shifts in the bargaining power of transnationals and host governments at specific moments. When transnationals are about to make a new commitment, the balance of power shifts in favour of the transnational.[122] The host government's decision to grant incentives to the transnational depends on the size of the investment, the long-term revenue potential of the investment, the oil company's willingness to make a huge commitment, and its overall success in exploring for and producing oil.

> The value of supporting the international investors will be restricted more and more exclusively to those periods when the balance of power is on the side of the foreigners - under conditions when they can be enticed to bring new corporate resources to the service of the host country. At these times, the perception of the cost of replacing or doing without the foreigners

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[119] Moran, "Risk Assessment," 112.
[120] Ibid., 113.
[121] Encarnation, Dislodging Multinationals, 24.
[122] Moran, Politics of Dependence, 168-9.

services is very high.[123]

Suharto believed that he could sever the relationship with Stanvac but that he could not afford to end the Caltex connection. The Caltex connection could not be terminated because the cost of doing without its services were still too high. As a public policy decision, the state had decided not to expend huge capital resources on the oil industry. Projects requiring billions of dollars would be the preserve of the transnationals. Caltex's experience and its position as a long-term producer in Indonesia could not be replaced easily. Thus the state would not call the transnational's bluff by threatening to hire another company for a fee.[124]

The oil companies still exercised considerable structural power in the international oil industry which oil-producing countries could not easily challenge. As Ir. Wijarso, the former Director General of Migas who negotiated the deal with Caltex, noted, Caltex continued to enjoy a near-monopoly over the technology for secondary and tertiary recovery and the finances to back its application. He argued Pertamina could never hope to gain the world-wide experience in diverse oil terrains that the Caltex had accumulated over the decades. With their large research and developments budgets, oil companies had continued to improve their oil exploration, production, and refining technologies.[125]

For Suharto, the option of terminating Caltex's activities was too costly, the demand that Pertamina's bureaucrats were consistently upholding. Suharto had waived the state ownership alternative, surrendering the paramount and the most potent bargaining card that the state may play against the transnational, because of his political unwillingness to end the involvement of transnationals that made large contributions to the state's budget. Caltex was indispensable, Stanvac was not. Pertamina bureaucrats could try their hand at running the Stanvac area on their own, but Suharto was unwilling to threaten the huge "bonanza" that Caltex promised to provide. Within three years this decision proved to be sound. In Pertamina's hands even production from Stanvac's former contract area declined.[126] Having accumulated knowledge about the character of the Indonesian government's demands and weaknesses, Caltex had played its cards correctly by tying its willingness to commit greater resources to the Indonesian oil industry to a reduction in the host government's demands. Caltex had learnt to sequence its investments.[127] It thus created the conditions for its own stable existence in Indonesia and preempted the government's demands for an exorbitantly larger share of rent.

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[123] Ibid., 221.

[124] High-ranking government official, interview by author, Jakarta, 5 May 1987.

[125] Ibid.

Caltex executives warned Suharto that they would not be willing to continue their operations if the government implemented all its demands.[128] They emphasised that secondary and tertiary recovery were essential to expand Indonesia's declining oil production. Caltex's investment program involved U.S.$1.5 billion and the drilling of 4,500 wells in the world's largest secondary recovery program in the Duri field.[129]

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[126] High-ranking government official, interview by author, 27 May 1987.

[127] Moran, "Risk Assessment," 113.

[128] Corporate executive, Chairman Managing Board, interview by author, Jakarta, 5 January 1987.

[129] For a discussion of Caltex's secondary recovery program by the Chairman and Chief Executive officer of Chevron Corporation George M. Keller see The Jakarta Post, 9 October 1985. The Duri field, operated by P.T. Caltex Pacific Indonesia is located in

Another $1.5 billion had been allocated to the ageing Minas field, Indonesia's biggest producing but declining field from which 300,000 bpd could only be extracted with secondary recovery techniques.[130] Secondary recovery would boost total recovery of the oil originally in place to more than 50 percent as against less than 10 percent recovery from primary methods.[131] Caltex had a sophisticated research and development program. It could raise capital on international financial markets. It understood the geology of the site better than any other company.

Caltex also used its marketing expertise card. Caltex transported oil to the Western hemisphere where it had established markets. The company alerted the President and other government officials that the price of the Indonesian bench mark crude, Minas, might be adversely affected if Caltex's refineries refused to take Indonesian crude oil.[132] The Indonesian state would have difficulty in obtaining market share, particularly in the sluggish market conditions that had begun to appear in 1983.[133] As it will be remembered, in 1977, Caltex had employed similar tactics. Then also it had warned the Indonesian government that it would shelve its secondary recovery program in the Minas

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the Riau province of Sumatara Island. Discovered in 1941, commercial production began in 1958. According to one estimate Duri has 7.1 billion stock tank barrels and is touted as the largest heavy crude oil accumulation in the world. Peak production was expected to be 285,000 bpd which would require 56,000 bpd or almost a fifth to produce. Over a 40 year period the project was expected to recover 58 percent of the original oil. P. Soegianto and R Sudibjo, "Duri Steamflood Project," Seminar on the HTR-Modul Technology, Jakarta, 29-30 June 1987.

[130] G. Vernon Hough, "Indonesia: Production Cuts," Petroleum Economist, June 1982, 249.

[131] Chairman, Management Board, major oil company, interview by author, Jakarta, 16 January 1987.

[132] Ibid.

[133] Ibid.

field if the government insisted on charging US $1.00 per barrel supplemental payment on oil transported to distant markets.[134] It had demanded that the fields in which secondary and tertiary recovery was to be conducted should be classified as new fields for which it would obtain the new field incentives.[135]

Suharto could have told Caltex that he would invite another major such as Mobil Oil or Exxon to conduct the operation. With their economic resources, transnationals can successfully wage economic warfare on a host government for which oil constitutes a singularly most important life-line. To achieve their ends, transnationals will bring this power to bear and remind the state in no uncertain terms that it is upon them that its continued access to oil revenues depends.

Caltex asserted that its decision to postpone depreciation and investment cost recovery over and above US $113,545,000 for sixty months was a concession to the government since it could contractually depreciate all its investments by the end of its contractual period.[136] Haroen Al Rasjid had also informed Minister Subroto that his parent company had other lucrative investment opportunities and that it would reduce its investments in Indonesia if the government insisted on an equity split exceeding 88:12. Subroto had conveyed this message to the President.[137]

But Caltex also had another bargaining card which it could play, over and above the normal bargaining resources that transnationals usually employ. Transnationals do play politics and derive the power to manipulate, control, and to dominate markets and governments to varying degrees with their superior economic and technological prowess. They will utilise their personal relationships with the decision-makers of the state to gain added leverage and if necessary to nullify the bargaining power that the bureaucracy has accumulated. Caltex executives went over the heads of the Director General of Oil and Gas, the Minister of Mines and Energy, Pertamina's BKKA and its President-Director. They took the matter directly to Suharto.

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[134] Mark Johnson, "Oil I: Recent Developments," Bulletin of Indonesian Economic Studies 13 (November 1977), 36-7.

[135] High-ranking government engineer, Jakarta, interview by author, 25 March 1987.

[136] Letter from Caltex Pacific Indonesia to Pertamina, no. 721 dated 24 June 1983.

[137] The Jakarta Post, 12 December 1983.

From then things moved quickly. As one observor noted, "Once Suharto took the decision to allow Caltex to stay, the forces opposing its continued association with Indonesia gradually subsided."[138] Caltex was told that it would have to give something better than 85/15. So after some haggling, it was determined that 88/12 was a reasonable split.[139]

Caltex led the way in demonstrating how the power of the bureaucracy, its knowledge and expertise could be nullified in one stroke, and how its aspirations to replace the transnationals in their upstream operations could be dampened in a trice. Thus the oil company had successfully stemmed the threat to its autonomy and had re-asserted its dominance in its alliance with the Indonesian state by using its veto power - its monopoly over expertise, its capital resources, its control over Indonesia's oil markets, the detrimental impact its withdrawal might have on the price of Indonesia's bench-mark crude, and its ability to successfully play politics.

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[138] Corporate executive, major oil company, New York, 19 October 1986.
[139] High-ranking government official, Jakarta, 21 March 1987.

The dependent state at times is forced to make compromises with foreign capital in the long-term interests of capital accumulation. Suharto had himself espoused the view that Caltex had exploited the government's weakness in 1971. But now he turned on his own bureaucracy as he saw it threatening the long-term capital accumulation goals that Caltex would secure. Pertamina and the BKKA were explicitly and painfully made aware of the limits of their power and the boundaries that they could not cross if they did not wish to "endanger" the health of the Indonesian economy. The re-negotiation of the Caltex contract would bring the government an additional revenue of US$ 2 billion a year, which equalled 50 percent of total non-oil export earnings in 1982.[140]

Since the issue had been publicly discussed, the foreign company had to give government officials and Suharto a face-saving device. State officials cannot be allowed to walk away from the bargaining table empty-handed. The state's bargaining power increases in high-visibility situations, when dealings between the government and company are widely publicised in the press and the media.[141] A Caltex executive noted that Caltex was considered to be the epitome of American transnational domination in the Indonesian oil industry.

> We were afraid that we might be dragged into a political snowball. Caltex's activities are always being thrown into the limelight. Indonesians were particularly critical of Caltex because it is the biggest producer and because of its long association with the concession system and the contract of work which were seen as intolerable colonial appendages that they had been forced to accept.[142]

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[140] Indonesian Commercial Newsletter, 19 December 1983, 3.

[141] Robert Grosse, Multinationals in Latin America (London: Routledge, 1989), 83.

[142] Corporate lawyer, major oil company, interview by author, Jakarta, 17 February 1987.

But transnationals will prefer to make some concessions rather than endanger their absolute revenues from the project unless they are seriously considering withdrawal. Caltex had a vested interest in the Indonesian oil industry, a major contributor to its world-wide profits. In a paper entitled "Indonesian Oil and Gas," Paul Mlotek of Salomon Brothers Inc. estimated that in 1984 34 percent of Texaco's and 25 percent of Chevron's profits were made from Indonesia.[143] It could ill afford to be hostile to a government which so reasonably accommodated its interests in the pursuit of joint-maximising goals.

The argument that manufacturing firms cannot be held hostage in the same way as natural resource industries also came to be applicable to the natural resource industries as the easier oil wells and areas became increasingly depleted and higher technology came to be applied to natural resource industries such as secondary recovery, deep drilling, and exploration in remote areas. In such cases the balance of power swings in favour of the transnational corporation. It is not only when transnationals make new corporate commitments but also when they use new technology that the supply price for their services rises sharply. They can use technology as a potent bargaining card. Still, manufacturing firms do have access to greater flexibility in that they can threaten to move their operations to more favourable climes, an action that a natural resource company is unable to take.[144]

As Penrose notes, the transnational may in reality concede less than is publicly visible because of a variety of hidden ways in which transnationals can derive incentives from the host state.[145] Although Caltex accepted Zahar's stipulation that it should divide its fields into new and old field categories, it segregated the field into 15 areas so that each "project shall be treated as a separate enhanced recovery project eligible for investment credit and pro-rata incentives."[146] The Caltex estimate would be used to determine how much oil was to be attributed to primary production and how much to secondary production.[147] As many a resentful oil bureaucrat noted, the company steadfastly held on to the building in which its offices are housed, a luxurious work place compared to the Ministry of Mines and Energy offices a few hundred yards away. Technically the Caltex building should have reverted to the government after the contract of work ended.[148] But who would argue with Caltex for a few hundred thousand dollars when billions of dollars were at stake?[149]

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[143] U.S. Embassy, Indonesia's Petroleum Sector (Jakarta: U.S. Embassy, 1985), 58.

[144] Kobrin, "Testing the Bargaining Hypothesis," International Organization 41, (Autumn 1987), 613.

Not only did Suharto take Caltex's demands seriously but he also removed the offending bureaucrats from Pertamina. Jack Zahar was transferred to the Pertamina subsidiary P.T. Elnusa. Judo Soembono was replaced as Pertamina's President-Director by A.R. Ramly. Few were sorry to see Sumbono go. He had a reputation of being unable to reconcile conflicting views and of being discourteous to Pertamina's most valued international customers. He had not completed his task of making the company auditable by the end of 1983. The technocrats, involved in raising a major US $1 billion loan, were concerned about yet another financial crisis when the major oil companies complained that Pertamina was not paying its bills on time.[150]

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[145] Penrose, The Growth of Firms, 156.

[146] High-ranking government official, interview by author, Jakarta, 21 March 1987. See also letter from Caltex to Pertamina, 17 October 1984.

[147] High-ranking government accountant, interview by author, Jakarta, 20 January 1987.

[148] High-ranking government lawyer, interview by author, Jakarta, 3 December 1987.

[149] Ibid.

Suharto reassured the transnationals that their participation in the oil industry would remain undisturbed and they would be allowed to derive a reasonable rate of profit because of the Indonesian inability to replicate the functions of the transnationals.[151] Subroto stressed the importance of foreign participation in the industry, especially in the field of investment and technology, until the national oil industry can be fully relied on.[152] In a business dinner upon his installation as the new President Director Ramly pointedly noted that it was Pertamina's task to manage "unbusiness-like" matters so as to accommodate them within the framework of the production-sharing contract, which was negotiated "in a very business-like manner."[153] The state had to give priority to domestic products, tighten conditions for employment of expatriates, accelerate Indonesianisation and create opportunities for increased participation by domestic companies.[154] But these objectives would not achieved at the expense of the foreign oil-producing companies. The state would institute procedures to prevent the immoderate use of its regulatory powers so that it did not jeopardise its partnership with the transnationals.[155] Ramly promised to "... interpret our government's policies in a pragmatic and acceptable manner to guarantee a smooth implementation of our production-sharing contracts."[156] But Suharto did not dismantle the bureaucratic structure to monitor the activities of the transnationals. While promising that the bureaucracy would monitor the transnationals' activities in a more meaningful way, he stressed that foreign investors were expected to follow the government's policies that coincided with its development efforts.[157]

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[150] Susumu Awanohara, "Suharto's Axe Falls," Far Eastern Economic Review, 5 July 1984, 41-2.

[151] "Oil, Foreign Investments Still Vital," The Jakarta Post, 26 July 1984.

[152] Ibid.

[153] A.R. Ramly, "Welcoming Address at the Welcome Dinner By Pertamina For Its PSC's in Jakarta," 28 June 1984 cited in U.S. Embassy, Indonesia's Petroleum Sector (Jakarta: U.S. Embassy, 1984), 30.

[154] Ibid.

Conclusion

In this chapter I have shown how the state became increasingly activist in response to changing international and domestic factors. It had the revenues to chart a more independent course for itself and for the domestic entrepreneurial class. And it had the expertise and the institutional structure to monitor the industry in a more meaningful way. But the rational dependent state cannot afford to endanger its long-term capital accumulation goals by entering into an all-out fight with the transnationals when it will reap huge benefits by continuing the association. Several scholars have argued that host states do face short-term reversals in their encounters with transnationals even though there is a general improvement in their bargaining position.[158]

In this case, there was ideological support for a more stringent approach to the transnationals within the state apparatus. But there were internal divisions within the state apparatus about the extent to which and the harshness with which the economic nationalist line was to be implemented. The contract-of-work was still under the jurisdiction of Migas until it was renegotiated. Migas tended to take a more pragmatic approach so that Pertamina's technical experts could not arbitrarily take an unfavourable decision towards Caltex. In addition, Suharto would have the final word. When indeed Suharto did take the final decision it coincided with the Migas line. Pertamina's bureaucrats saw this action as a reflection of a lack of political will. But Suharto and Wijarso saw it as the best possible bargain that the state could strike with the transnationals and as a necessary supply price to be paid to Caltex in light of the fact that they did not wish to endanger the state's long-term revenues. That is, these state managers were not willing to play a zero-sum game with Caltex. They were convinced that the cost of doing without Caltex's services would be detrimental to the Indonesian oil industry. Indeed, later Wijarso emphasised that he had not even been willing to terminate Stanvac's contract. He cited that contract area's tapering production since it came to be controlled by Pertamina as ample proof of his earlier conviction that Pertamina was unable to maximise oil production. But Wijarso had conceded to Pertamina's demands as a compromise so that they would not endanger the rich revenues that the state expected from Caltex's fields.[159]

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[155] Ibid.

[156] Ibid.

[157] Suharto, "Oil Investments Still Vital," 26 July 1984.

[158] See for instance Shepherd's comments on Girvan's analysis of the Jamaican bauxite industry in Shepherd, "International Cigarette Industry," 60, n. 2.

That Suharto and Wijarso were willing to concede to Caltex's demands was not the product of a lack of political will to bargain. The state had the administrative capacity to implement its decisions and it would have been possible to garner institutional unity within the state apparatus if there had not been contradictory notions of how the national interest could best be served and how far to push the transnationals without endangering the long-term interests of capital accumulation. For a "reasonable" nationalist an 88 percent share of the revenue from Caltex constituted a victory for the state. The original bargain had obsolesced. The state had become more autonomous than before but it was still dependent.

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[159] High-ranking government official, interview by author, 15 September 1986.

UNIVERSITY OF ALBERTA

INDONESIA: BARGAINING AND DEPENDENCY IN THE PETROLEUM AND TEXTILE INDUSTRIES

BY

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©

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the Petroleum and Textile Industries

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Chapter 8

Bargaining in the Era of Benign Nationalism

This chapter shows that changing international conditions and lack of cooperation among the major players in the oil market eroded the oil producing countries' tax base with respect to transnational corporations. While relative market stability had existed in the era of de facto vertical integration, it was cooperation among the large vertically integrated oil majors until the early 1970s, and then between host states and cooperatively linked transnationals until 1979, that made stability possible. OPEC had itself eroded this cooperative bond with its transnational allies in the 1979-1981 period. Host governments were forced to address this question in the late 1980s. But they also maintained their bargaining vitality with transnationals. It was the era of the benign bargain.

Globalisation contributed to a more benign bargaining phase in the interactions between host governments and transnationals. But it was also the product of the greater knowledge and expertise of host governments. Host governments were not pushed to the extreme end of the bargaining continuum. They had access to their location-specific assets; firms had access to their firm-specific advantages. Technology in the oil industry had become more dynamic as the need to develop cheaper methods to produce oil in harsher terrains became essential for host states and the transnationals to maximise their long-term revenues. This factor added to the bargaining power of the transnationals. The peaceful era in host country\foreign investors relations contributed to more equitable bargaining.

But host states which now captured most of the rents from their oil industries had to concede some of those profits to the transnational corporations. As the bargaining "balance of power" model predicts, declining market conditions can reduce the bargaining power of natural resource producing states just as stable market conditions had in the recent past enabled them to extract some irreversible gains from the oil transnationals.

Section I

As distinct from the first half of this century, after 1986 the oil producing countries' weakness with respect to the oil companies was not the product of ignorance. It was the result of market conditions, for which they themselves were partially responsible. This encounter between oil companies and producing states was characterised by "an uneasy balance of power."[1] The oil companies had lost their control over production in the 1970s. Now in the 1980s the oil-producing countries no longer had command over prices, with the emergence of the spot and futures market, new sources of oil, and the glut in oil supplies. "The effect of these changes has been to claw back the apparent gains of the producing states through their recognition of the legitimate expectations of the companies."[2]

In the oil industry, gone were the days when economic nationalism reigned supreme. In the 1980s a world-wide fatigue with economic nationalism and state enterprises could be discerned at a global level as protectionism began to wane and states jumped on the deregulation and competitiveness bandwagon, beginning with British Prime Minister Thatcher's "good house-keeping" monetarist policies. When the price of oil crashed to US$ 9 a barrel in the spring of 1986, oil-producing countries with barely diversified economies were left with few options but to re-examine their relations with the transnationals, upon whom they depended for upstream exploration and development, for distribution and sales outlets, and for revenues from oil purchases. Indonesia, which depended on oil for 70 percent of its foreign exchange earnings, was one of these countries.

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[1] P.T. Muchlinski, "Law and the Analysis of the International Oil Industry," in The International Oil Industry ed. Judith Rees and Peter Odell (Houndmills: Macmillan, 1987), 150.

[2] Ibid., 151.

In Indonesia, the deregulation debate and process, the oft-repeated plea of the World Bank and the technocrats, began haltingly in 1983.[3] In 1981 even Sumarlin had taken offense at the World Bank's report which sharply criticised state intervention in the economy.[4] Now he was back on track again. The earlier commitment of the economic nationalists to import-substitution industrialisation had to be checked.

Deregulation began with the reform of the banking sector in 1983. In thirty months of trade deregulation from May 1986 to November 1988, the government dismantled half the non-tariff barriers (NTBs) that covered approximately 1,500 imported items and 35 percent of the value of imported items until October 1986.[5] Through the mid-1980s a public discussion of private and public monopolies, which had caused the Indonesian economy to become high-cost and internationally uncompetitive, filled many newspaper headlines. By 1988 the ending of the domestic plastics monopoly, in which President Suharto's sons had an interest, was seen as a major breakthrough.[6]

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[3] For good surveys of the deregulation process see the regular series, "Survey of Recent Developments," in the Bulletin of Indonesian Economic Studies and the annual surveys of Indonesia in the February issues of Asian Survey. For a good discussion of the deregulation process until 1988 see M. Hadi Soesastro, "The Political Economy of Deregulation in Indonesia," Asian Survey 29 (September 1989), 853-869.

[4] Guy Sacerdoti, "Overdraft of Inefficiency," Far Eastern Economic Review, 29 May 1981, 44-47. Idem, "The Technocrats Success Story," Far Eastern Economic Review, 29 May 1981, 48-49.

In the oil industry, the impact of the deregulation process was felt in reduced subsidies for domestic products and the privatisation of gasoline stations.[7] And, more importantly, it was seen in the relaxation in the regulatory process for the upstream oil-producing transnationals and for the transnationals in the oil supply and service sector.

Section II

In 1979/81, OPEC governments themselves were responsible for ending their long-term supply arrangements with the oil companies. Spot crude market prices rose faster than government official selling prices, allowing the companies with preferential contracts to obtain exorbitant profits. Several OPEC governments found this circumstance intolerable. Earlier fears of sluggish prices were wiped out in the sellers' market produced by the crisis.

Consequently, through late 1979 and 1980, many OPEC countries enhanced the legitimacy of the spot market, reneging on their long-term contracts and taking advantage of the higher premia available on the spot market.[8] During the crisis, crude-short transnationals had lifted crude at premium prices.[9] A dramatic feature of the transition from the pre-1979 to the post-1979 oil market was that the oil majors were eased out of their role as crude traders.[10] During the Iranian crisis, the oil majors phased out third-party contracts pleading force majeure,[11] and could no longer be considered reliable suppliers.[12]

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[5] Soesastro, "Deregulation in Indonesia," 854.

[6] Ibid., 857.

[7] The Jakarta Post, 7 April 1987.

The result was that the companies lost their marketing role for crude. By 1982, private oil companies held title to less than 20 percent of product and had access to only a third of production on long-term preferential contracts compared to over 90 percent in 1970.[13]

The Iranian revolution and its aftermath of soaring prices ended most of the majors' access to preferential crude except for Saudi Arabia's Aramco and the production of countries such as Indonesia. By the end of 1979 only about 15 percent of OPEC crude exports moved through preferential contracts. Until the seventies, third party transactions in crude did not exceed 20 percent of total volumes moving. Since contracts then often had a three-year term, it used to be estimated that only about 7 percent of annual crude supply was priced in arm's-length deals made in any year.[14] Another kind of preferential sales from OPEC countries rose to a peak - government to government deals.[15] They constituted 20 percent of OPEC's crude exports between 1979 and 1980.[16]

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[8] Throughout 1980, Kuwait unloaded 700, 000 bpd of its total production of 1 million bpd. Petroleum Economist, January 1980, 42. Also see Petroleum Economist, February 1980, 46-7. For Kuwait's new short-term agreements with the oil majors, see Petroleum and Taxation Report: Review of 1980 (New York: Gordon Barrows, 1981), 25. For Libyan reductions, see Petroleum Economist June 1981, 257. For Iranian reductions, see Petroleum and Taxation Report: Review of 1979 (New York: Gordon Barrows, 1980), 59.

[9] British Petroleum's supplies were reduced from 385,000 bpd in 1979 to 125,000 bpd in 1980. Shell's supplies were reduced from 195,000 bpd in 1979 to 95,000 bpd in 1980. Petroleum and Taxation Report: Review of 1979 (New York: Gordon Barrows, 1980), 18.

[10] Petroleum Economist, May 1983, 166; also see Jochen H. Mohnfeld, "World Oil Markets - Implications of Structural Change," Petroleum Economist, July 1982, 270.

[11] Petroleum Economist, July 1982, 271.

[12] Petroleum Economist, January 1980, 42. In 1981, only 1 mbd were sold to third parties on short term contracts, primarily by the Aramco partners. Mohnfeld, "Structural Change," 270.

[13] Paul Stevens, "A Survey of Structural Change in the International Oil Industry, 1945-1984," in The Changing Structure of the World Oil Industry ed. David Hawdon (London: Croom Helm, 1985), 36; see also Petroleum Economist, January 1980, 42.

The structure of the post-1979 market was decidedly different from the pre-1979 period. The spot market and the futures market, which had played marginal roles prior to 1979, emerged as important structural features of the market after 1979. The Iranian Revolution served as the catalyst which gave the spot market the status of a legitimate institution for buying and selling oil. Until early 1979, spot market sales constituted approximately 10% of the total volume of crude oil produced.[17] After 1982 approximately 85 percent of crude moving in inter-regional trade was sold arm's-length and 65 percent of it could be bought by anyone at the same price.[18]

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[14] Jack E. Hartshorn, "Government Sellers in a Restructured Crude Oil Market," in The Changing Structure of the World Oil Industry ed. David Hawdon (London: Croom Helm, 1985), 60.

[15] Mohnfeld, "Structural Change," 269; Hartshorn, "Government Sellers," 60.

[16] Mohnfeld, "Structural Change," 269.

[17] Petroleum Economist, February 1979, 82; Petroleum Economist, March 1979, 134.

[18] Hartshorn, "Government Sellers," 60.

The era of short-term, flexible contracts had begun.[19] The old long-term contract was "replaced by a term contract, usually a sort of 12 month ever-green type of deal with appropriate re-opener and phase-out provisions."[20] At the height of the crisis governments changed prices and cut volumes so that when the crisis was over the buyers no longer valued the long-term contract. The spot market provided the crude-producing countries with an alternative outlet and the oil majors with an alternative crude supply source.

The large vertically integrated oil companies gradually withdrew from their role as crude traders. They remained partially integrated firms and continued to dominate refining and marketing. They were particularly prominent as product traders. The oil majors' equity production was below 15% in 1984 compared to 90% ownership a decade before.[21] But they continued to have some oil supplies from their production-sharing, equity or preferential agreements with a number of OPEC and non-OPEC governments such as Saudi Arabia's Aramco and Indonesia's production-sharing contract.

The new structural conditions in the oil market made it harder for OPEC to impose price and production discipline. Following the price shock of 1979/1981, demand for OPEC oil fell from 31 million bpd in 1977/1979 to 17.5 million bpd in 1983.[22]

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[19] Petroleum Economist, January 1984, 13.

[20] Ian Seymour, "OPEC and Structural Change," in The Changing Structure of the World Oil Industry ed. David Hawdon (London: Croom Helm, 1985), 76.

[21] Jack E. Hartshorn, "Changing Management Strategies," Petroleum Economist, June 1984, 206; According to the UNCTC, the nationalisation of the oil majors' properties reduced their equity crude from 61 percent in 1970 to 25 percent in 1979. UNCTC, Transnationals Corporations in World Development Third Survey (New York: United Nations, 1983), Table V.1.

[22] Ian Seymour, "OPEC and Structural Change," 72.

OPEC's share of what then constituted non-Communist production fell from 63 percent in the early 1970s to 42 percent in 1983.[23] As a proportion of that area's supplies, demand fell from 39 percent in 1973 to 19 percent in 1983.[24] Four factors reduced demand for OPEC oil: energy conservation, oil substitution, the world-wide economic recession of the early 1980s, and increased non-OPEC production.

World demand fell dramatically with the second oil price shock. The combined effect of the Iranian Revolution and the outbreak of the Iran/Iraq war led to a significant increase in real prices and to a reduction in world demand by 5 percent in 1980. Despite the fall in real prices by 25 to 30 percent from 1981-1985, demand continued to fall. During the 1980s, gains in energy efficiency and conservation - together with increases in non-OPEC oil supply - cut deeply into OPEC's market share, eventually precipitating the netback marketing campaign and subsequent crude oil crash of 1986.[25]

What was the impact of this changed market structure on the oil companies and host governments? How did it affect the bargaining power of host governments?

The changing structure of the oil market following vertical disintegration has made it clear that the companies do not require vertical integration for their survival. The oil companies have not only survived the erosion of their firm-specific advantages but they have remained strong. By 1981, as the conditions of over-supply became evident in the face of diminishing demand, the advantages of long-term contracts resurfaced for the oil-exporting countries.[26] But the transnationals had regained the balance between their crude supplies and their refining requirements.[27] Long-term contracts were no longer attractive.[28] Contracted volumes were reduced.[29] So were premiums.[30]

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[23] Ibid.

[24] Ibid.

[25] Anthony E. Reinsch, Kevin J. Brown, and James O. Stanford, Stability Within Uncertainty (Calgary: Canadian Energy Research Institute, 1988), 19.

Seeking to maximise their crude reserves-to-production ratios, the oil majors and large independents pursued three strategies in the depressed price regime. First, through mergers and acquisitions they acquired cheap oil reserves, particularly in North America and Europe.[31] Since 1979 they had only committed investments in those OPEC countries with profitable investment regimes. These developments reduced their vulnerability to host governments.

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[26] Petroleum Economist, May 1979, 218.

[27] Petroleum Economist, July 1982, 270.

[28] Petroleum Economist, July 1982, 181.

[29] Petroleum Economist, November 1983, 443.

[30] For Kuwait, see Petroleum Economist, June 1981, 257-8. For Saudi Arabia, see Petroleum and Taxation Report: Review of 1981 (New York: Gordon Barrows, 1982), 9.

[31] The take-over wave began in 1979. But the 1984 merger wave was unequalled. Excluding the hundreds of divestures, nearly U.S. $51 billion was disbursed in corporate mergers. A New Republic editorial lamented "the short-sighted cupidity of our energy providers." cited in Petroleum Economist, July 1985. This wave included Chevron's acquisition of Gulf for U.S.$13.3 billion in 1984, Texaco's acquisition of Getty Oil for 10.1 billion, Mobil's purchase of Superior Oil for U.S.$5.7, and Royal/Dutch Shell's acquisition of Shell Oil (U.S.) for 4.5 billion. Petroleum Economist, July 1985. In addition, Exxon bought up large amounts of its own stock on the grounds that it was adding to its reserves at an average cost of $2.50 per barrel compared with $5-10 per barrel in the huge mergers that took place during the year. Petroleum Economist, August 1984, 297. It spent $17 billion to acquire these shares. The Economist, 5 March 1994, 69. British Petroleum purchased Standard Oil for U.S.$7.5 billion in 1987. Belridge Oil (U.S.) for U.S.$3.6 billion in 1979. David Gold, "Technological and Organisational Changes and TNC strategies in the 1980s," The CTC Reporter, (Autumn 1988) 24-6. In addition, Kuwait Petroleum procured the oil service company Santa Fe International (U.S.) for U.S.$2.50 billion in 1981; the Saudi Arabian American Oil Company bought a 50 percent share in Texaco's Eastern U.S. network for U.S.$0.80 billion in 1988. These were some of the major acquisitions of U.S. oil companies in the 1980-1988 period. United Nations Centre on Transnational Corporations, The Process of Transnationalization and Transnational Mergers (New York: United Nations, 1989), 36-39; see also, Donald O.Croll, "U.S. Oil Companies - Merger Wave Hits Majors," Petroleum Economist, April 1984, 125-7. Also see Donald O.Croll, "U.S. Oil

Relatively and absolutely the oil industry's "leviathans of fifty years ago are still its leviathans."[32] In 1983 Exxon's sales were U.S. $95 billion; its net profits, U.S. $9 billion.[33] A decade later Exxon's sales were U.S. $111 billion and its profits U.S.$5.3 billion despite the downturn in oil prices and a U.S.$3.5 billion pay out for the Exxon Valdez fiasco.[34] Its production totalled 1.7 million bpd, a little below Nigeria's, its refinery runs 3.3 million bpd and its product sales 4.9 million bpd.[35] Its production exceeded Indonesia's. According to Petroleum Intelligence Weekly's index of the fifteen largest oil companies in the world, the six sisters" still ranked amongst the top ten.[36]

Total profits for the seven largest U.S. oil companies totalled $15.3 billion in 1988.[37] In 1989 dollars these profits approximated their 1974 profits of $15.9 billion.[38]

Companies - Mergers Reshaping the Oil Industry," Petroleum Economist, July 1984, 253-4.

[32] See Exxon's recent corporate profile in The Economist, 5 March 1994, 69-70.

[33] Lord Kearton, "The Oil Industry. Some Personal Recollections and Opinions," in The Changing Structure of the World Oil Industry ed. David Hawdon (London: Croom Helm, 1985), 15.

[34] The Economist, 5 March 1994, 69.

[35] Ibid.

[36] "PIW Ranks World's Top 50 Oil Companies," Petroleum Intelligence Weekly: Special Supplement Issue, 12 December 1988, 1-4.

[37] Petroleum Intelligence Weekly, 30 January 1989, 9; Their profits had fallen considerably from the 1980-1982 period when their combined profits had peaked at $32.8 billion in 1980 and had fallen to $29.2 billion in 1981 and $29.8 billion in 1982. John L. Portella, "Oil Politics and Economics," Paper, 26 Annual Convention of International Studies Association, Washington D.C., 8 March 1985 cited in Stephen Gill and David Law, The Global Political Economy: Perspectives, Problems, and Policies (Baltimore: The John Hopkins University Press, 1989), 263.

[38] Ibid., 262-3.

Although their upstream profits had declined, their profits from refining, marketing, and chemicals had increased.[39] The oil companies had re-structured and stream-lined operations with a greater emphasis on efficiency and productivity through work-force reduction, shut-downs of excess capacity, disposals of unneeded tankers, and similar measures.[40] The oil majors continued their upstream expenditures primarily outside the U.S. The exploration budgets of Exxon, Royal Dutch/Shell, and British Petroleum amounted to $2.4, $2.1, and $2.8 billion respectively.[41]

At the same time partial integration was and is still a priority for the transnationals. Luciani makes two notable points. First, from a hypothetical standpoint no company would be at a competitive disadvantage with respect to its rivals in times of shortages if none of them were vertically integrated and if they all depended on a "large and transparent market."[42] But since all the majors are partially integrated with some of their own crude supplies, they will continue to seek their own crude supplies to circumvent their rivals if the perpetual possibility of shrinking world supply emerges. Indeed, it has been a prime strategy for the oil majors to remain partially integrated even if their crude supplies now trail far behind their downstream assets.[43] Giacomo Luciani argues that "any company that sees a future for oil and sees itself as primarily an oil company" would eventually have to achieve stability in crude supplies.[44] And, for this, he argues, their rather disappointing and expensive experiences in non-OPEC countries will keep them dependent on the Arab world.[45]

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[39] Petroleum Intelligence Weekly, 30 January 1989, 9.

[40] Donald O Croll, "U.S. Oil Companies: Slow Recovery in Earnings Last Year," Petroleum Economist, March 1984, 98-99.

[41] Petroleum Intelligence Weekly, 16 January 1988, 2.

[42] Giacomo Luciani, The Oil Companies and the Arab World (London: Croom Helm, 1984), 66.

[43] Petroleum Intelligence Weekly: Special Supplement Issue, 12 December 1988, 1-4. According to the integration index of Petroleum Intelligence Weekly, calculated by dividing liquids production by refining capacity, all the oil majors had refining capacity far in excess of own crude supplies. This index demonstrates the extent to which the oil industry has become disintegrated. The oil majors had too much refining capacity

National oil companies have come to play a significant role in the oil market. They are vertically integrated but not in the global sense.[46] Saudi Arabia ranked first on the Petroleum Intelligence Weekly list of top fifteen companies. Other companies on that list were Venezuela's PDVSA, Iran's NIOC, Mexico's Pemex, Kuwait's KPC. Indonesia's Pertamina ranked ninth, largely on account of its ownership of oil and natural gas reserves and its massive natural gas output.[47]

Vertical integration is not going to give the oil-producing countries the kind of oligopolistic control that the oil majors once exercised. Markets are too fragmented to allow such an occurrence. The national oil companies of the producing countries are only

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compared to upstream own production while the largest national oil companies were in these terms diametrically opposed. The integration index is as follows: Mobil 265%; Exxon 221%; Royal Dutch/Shell 233%: British Petroleum 157%; Chevron 201%; Texaco 201%. By contrast, the refining capacity of the oil exporting countries' national oil companies lagged much behind their production capacities. For example the integration index for Saudi Aramco was 27%. Mexico's Pemex, Venezuela's PDVSA with its domestic refineries, and Kuwait's KPC came closest to balancing their upstream production with their refining capacities - the integration index was 60, 76, and 84 percent respectively. Ibid., 2.

[44] Luciani, The Oil Companies, 67.

[45] Ibid., 67.

[46] Their main aim to integrate was to add value to their natural resources and to partake in the profits generated from the sale of products. Petroleum Economist, May 1983, 146.

[47] Petroleum Intelligence Weekly: Special Supplement Issue, 12 December 1988, 3.

marginally involved in exploring outside their own territorial jurisdictions.[48] They are not horizontally integrated firms with access to crude supplies spanning several continents. Their objectives are much narrower - adding value to their own crude and/or finding markets for it, and refining crude at cost instead of giving discounts or net-backs to crude buyers.

The producing countries' share of aggregate downstream assets in the oil consuming countries constituted only 2% of world demand in 1988.[49] This estimate preceded the Saudi acquisition of half of Texaco's downstream assets in the United States. Even then, total OPEC investment in the U.S. amounts to only 5% of U.S. refining capacity.[50] Refining and marketing still remain dominated by the large international majors, especially in product sales. Shell held a comprehensive lead. It sold one of every ten barrels of products in the geographical area outside what used to be called the Eastern bloc.[51]

From the perspective of this study, the important question is: in what way has the changed market structure affected the bargaining power of host states? "It was the forces of world demand that humbled OPEC."[52] Host states had to make concessions to the oil producing companies. Many of them still required oil companies' technical services and marketing skills.[53] Many OPEC countries had to make peace with the oil companies as they braved declining demand, tapering revenues and, in some instances, waning reserves-to-production ratios.[54]

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[48] Kuwait was one of the only OPEC countries which increased its world wide crude oil reserves because of exploration efforts in other countries. Francine Stock, "Kuwait: Building Through Investment," Petroleum Economist, December 1982, 504-5.

[49] John Wood Collins, "Downstream Integration: Myths and Realities," PIW Special Supplement Issue, 3 October 1988, 1.

[50] Petroleum Intelligence Weekly, July 11 1988, 5.

[51] Petroleum Intelligence Weekly, 12 December 1988, 1-2. Except for the Singapore government's 40% share in Singapore Refining Corporation in which BP and Caltex each had a 30%, Singapore, the world's third major refining centre, was completely controlled by five oil majors. Until 1983 about 40% of Singapore's capacity was used to process Indonesian and Malaysian crude. G. Vernon Hough, "Singapore: Growing Role of Oil Trading," Petroleum Economist, April 1983, 133. For the oil majors' control of Rotterdam's refining see "Rotterdam: West Europe's Oil Capital," Petroleum Economist, May 1987, 177.

In this context, it would be well to examine the classic questions that have interested oil industry analysts: whether vertical integration is essential to the transnationals' profitability and for market stability. From 1945 to the early 1970s there was a high degree of vertical integration in the oil industry.[55] Much has been written about the rationale for the oil industry's vertically integrated structure. Two broad themes can be identified. Coase and Williamson argued that vertical integration was the direct result of firms seeking lower transaction costs in internal markets. Blair and Teece stressed that the oil majors' prime objective was to restrain competition. Historically, much of the reason for vertical integration related to the monopolistic nature of competition. Refiners wanted their own sources of supply because the market for crude was imperfect and dominated by a few companies. Crude oil producers sought their own crude outlets to protect themselves against rivals and to achieve effective control over markets. But firms also benefitted from lower transactions costs in internal markets.

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[52] Reinsch, Brown, and Stanford, Stability Within Uncertainty, 22.

[53] Kearton, "The Oil Industry," 15.

[54] "The need for more vigorous exploration in these countries is obvious from a glance at their oil reserves statistics. OPEC's proved reserves have risen by only 2% from 436 billion barrels to 445 billion barrels since the end of 1974 when the process of expelling the companies began. This compares with a rise of 74% from 254 to 436 billion barrels in the preceding ten years when the companies were in control. Moreover, if we exclude Saudi Arabia whose reserves have gone up from 140 to 162 billion barrels, the aggregate for the remaining 12 has gone down." Petroleum Economist, August 1983, 291.

[55] Edith T. Penrose, The Large International Firm in Developing Countries: The International Petroleum Industry (London: Allen and Unwin, 1968); M.A. Adelman, The World Petroleum Market (Baltimore, Md: John Hopkins University Press, 1972), 92.

Penrose informs us that firms integrate vertically to deal with a "logistical problem: how best to arrange to get the right amount of a commodity to the right place at the right time."[56] and to prevent the monopolistic tendencies of their competitors. When refiners are faced with the possibility "of being deprived of a regular flow of supplies or of being charged with monopolistic prices, "and conversely, when crude producers face the possibilities of encountering a "monopolistic combination of buyers,"[57] of having no buyers at all, or of having to subsidize their buyers in an oversupplied market, the most logical solution that they may pursue is vertical integration.

The oil industry became vertically disintegrated in 1979. Vertical and horizontal disintegration did bring greater instability to the oil market. When the oil market was controlled by the large vertically-integrated firms, production had been restricted and crude and product prices were stable. The oil majors were able to achieve these objectives because their horizontal and vertical linkages gave them considerable knowledge about the activities of their counterparts and enabled them to coordinate their activities. But the oil majors did not constitute a cartel seeking to enhance their profits jointly, either upstream or downstream. In Hartshorn's words, they were the "business-in-between" juggling various interests to achieve their individual profit-making goals. They were neither perfect monopolists nor perfect competitors. "The individual interests of each company were different in most respects from those of every other, yet they could not afford unrestrained competition."[58]

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[56] Penrose, Large International Firm, 47.

[57] Ibid.

When the oil majors controlled crude supply there were few arm's-length transactions. Most crude was never sold on the open market. The oil companies transferred their crude to refining affiliates at inter-corporate prices. "Neither economists nor governments accepted those prices as market prices."[59] This had been the major disadvantage that governments had sought to redress by creating government selling prices.

Until 1979 there were few major structural changes in the market in this sense. Until the Iranian Revolution, the transnational oil companies retained their dominant position in downstream marketing and remained the largest sources of crude. They had access to more assured crude supplies than they could process.[60] Excess supplies were sold to third parties on long-term contracts.[61] Despite the loss of equity, the oil majors lifted substantial portions of host government crude at preferential prices which was fed into their global integrated systems.[62] As the decade wore on, the transnational oil companies became increasingly confident of their ability to gain access to secure crude supplies without equity ownership.[63]

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[58] Edith Penrose, "Downstream Implications of Structural Change," in The Changing Structure of the World Oil Industry ed. David Hawdon (London: Croom Helm, 1985), 87.

[59] Hartshorn, "Government Sellers," 61.

[60] While the majors' equity liftings declined to 13.4 mbd(57%)in 1978 from 25.5 mbd(or almost 85% of their offtake) in 1973, their total offtake fell by only 7 mbd. Mohnfeld, "Structural Change," 269.

[61] "In 1973, the majors had access to 30 mbd of crude oil. This accounted for 75% of internationally traded crude, primarily equity and preferential crude. Their refinery runs required approximately 23 mbd. In mid-1978, although they had a small surplus, they could sell three and a half mbd to third parties." Ibid., 269-70.

The participation agreements of 1973 guaranteed "the companies a profit margin ranging between 15 cents a barrel as a minimum for the-long term purchase contracts in the Gulf area as in the case of Kuwait oil to more than a dollar a barrel for crude liftings from their equity share in participation depending on the terms of lifting arrangements, participation and production costs."[64] Host governments gave the oil companies discounts and preferential crude in exchange for technical services.

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[62] See Hartshorn, "Government Sellers," 60-1. The oil majors agreed to market 80% of Saudi crude, Petroleum Economist, April 1976, 140; 45% of Iraq's output, Donald O. Croll, "New Directions Since Nationalization," Petroleum Economist, February 1978, 62-5. Before the Iranian Revolution the oil majors' were lifting about 4 million bpd of Iranian crude. Petroleum Economist, "Control of Crude Oil Supplies," September 1979, 350-1. In Libya Occidental Petroleum retained the right to lift 51% of the government's share without financial loss. Petroleum Economist, January 1976, 25. At the end of 1975, the oil majors had access to 63% of world production and 51% of refining capacity outside North America and the Communist world. "Control of Crude Oil Supplies," Petroleum Economist, September 1979, 350-51. also see Ian Seymour, Instrument for Change (London: Macmillan, 1980), 126.

[63] In their annual reports, the transnationals did not distinguish between their equity crude and the supplies available to them under special arrangements. Petroleum Economist, "Control of Crude Oil Supplies," September 1979, 350-1. The U.S. Federal Energy Administration dropped the distinction because " some of the contractual relationships may not be readily classifiable." Petroleum and Taxation Report: Review of 1975 (New York: Gordon Barrows, 1976), 167; United Nations Industrial Development Organization (UNIDO), Transnational Corporations and the Processing of Raw Materials: Impact on Developing Countries (Vienna: United Nations, 1978), table A.11.

[64] F.J. Al-Chalabi, OPEC and The International Oil Industry: A Changing Structure (London: Oxford University Press, 1980), 50.

Kindleberger argued that these developments upheld the validity of the Coase Theorem - a firm did not require equity ownership if it could control production and markets through a management and a marketing contract.[65] OPEC's national oil companies played a peripheral role in the refining and marketing end of the business. Although direct sales by the oil-exporting countries increased, their market share constituted a small percentage of total world trade.[66] Most of the crude was sold in government-to-government deals.[67] In pricing, the oil-exporting countries were forced to follow the lead of the majors because their dominant role in international markets gave them the ability to influence prices.[68]

In the sluggish market conditions of the latter half of the 1970s, for the first time since 1969-70, the transnationals could force host governments to reduce official prices for their buy-back preferential contracts.[69] To maintain their market power, the transnationals discouraged host and consuming governments from expanding their role in energy markets and establishing cooperative, direct dealings, for this would make them superfluous. And, they emphasised that downstream investments by OPEC's national oil companies were not economic.[70]

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[65] Charles P. Kindleberger, Multinational Excursions (Cambridge, Mass: M.I.T, 1984), 91-2.

[66] Direct government to government deals constituted 11% of world crude oil trade in 1978. Peter F.Cowhey, "The Engineers and the Price System Revisited," in Profit and the Pursuit of Energy: Markets and Regulation ed. Jonathan David Aronson and Peter F. Cowhey (Boulder, Colorado: Westview Press, 1983), 17. OPEC countries controlled only 6% of the world's refining and 3.2% of the petrochemical industry. Direct sales by the producing country national oil companies at the end of 1977 amounted to 1.5mb/d. Ali Jaidah's keynote address at OPEC sponsored seminar cited in Petroleum Economist, November 1977, 452-3. In 1977, OPEC refineries accounted for only 6.5% of world refining capacity with an actual throughput of 3.73 b/d. Petroleum Economist, March 1981, 122.

[67] In 1973 only 5% of OPEC oil was marketed by OPEC's national oil companies. By 1978 they sold 36 percent. Mary Ann Tetreault, Revolution in the World Petroleum Market (Westport, Conn.: Greenwood Press, 1985), 56.

[68] Al-Chalabi, International Oil Industry, 49.

[69] Countries such as Nigeria, unable to find outlets for their crude, were compelled to sign deals with the international oil companies which owned the processing facilities and controlled markets. Petroleum Economist, January 1976, 12-3. The Aramco partners

The transnationals could not be held hostage in the same way as they had been held hostage before. Their stake had been substantially reduced commensurate with a decline in their profits and equity share in their former concessions. Yet, in their interactions with host governments they could still bring to bear at least two, if not all three of their firm-specific advantages - capital, marketing, and technical expertise - without being quite so vulnerable.

This is not the place for a lengthy discussion about international cooperation between states, the reasons why they form cooperative organisations to pursue their interests, and about the ability of OPEC and non-OPEC countries and other powerful non-state actors such as transnational corporations to cooperate to achieve their self-

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reduced Saudi production by 17% in 1975 compared to the previous year. Petroleum Economist, May 1976, 190. Two years later, the Aramco partners were offering increased quantities of Saudi crude in an increasingly oversupplied market. Petroleum Economist, June 1977, 248. The Iranian consortium lifted only 85% of their crude nominations in 1975, and 76% of their crude nominations in the last quarter of 1976. Iran was forced to reduce prices. "Iran Cuts Prices to Boost Liftings," Petroleum Economist, March 1976, 102; See also Petroleum Economist, April 1976, 126. In 1975, Qatar's former concessionaires stopped lifting the country's crude because the two parties failed to agree on prices. Petroleum and Taxation Report: Review of 1976 (New York: Gordon Barrows, 1977), 25; Petroleum Economist, October 1977, 417. For illustrations of this trend in Kuwait, Iran and Nigeria see Petroleum Economist, February 1977, 42-3; Petroleum Economist, November 1977, 462; Petroleum Economist, November 1977, 454.

[70] Cowhey, "The Engineers," 15.

interested goals of maintaining market stability in the oil market. But the theoretical literature on international cooperation provides a framework for understanding the key factors that might enable OPEC to manage the international oil market. It is cooperation rather than vertical integration that appears to be the key to stability in the oil market.

Based on the realist assumption that nation-states are rational actors and with the aid of computer simulation, Robert Axelrod and Robert Keohane demonstrated that cooperation among states could be achieved through reciprocity.[71] But their conclusions which emphasised the potential for non-zero sum outcomes through cooperation, differed from orthodox realist theorising. Nation-states would choose to cooperate if there was increased and regular interaction among them, they had access to more information about their counterparts' actions, and sanctions for non-compliance were in place and enforceable. Regime analysis was popularised in the mid-1970s and the 1980s in association with the "theory of hegemonic stability" which seeks to explain how the U.S. served as a hegemon to stabilise the post World War II international economic and political order.

OPEC provides contrary evidence to the realist analysis provided by Susan Strange and Robert Gilpin, who see cooperative arrangements among states as primarily fulfilling the interests of its dominant members.[72] OPEC's role, since its inception, was to defend prices which brought equitable benefits to all its members in terms of what a barrel of oil could fetch. Since its emergence in 1960, OPEC's main rationale for existence was to protect and strengthen oil prices.[73] Since late 1973, by effectively managing the reference price of crude oil, OPEC had brought significant financial benefits to its members.[74] Of course, the larger producers benefitted more because of their larger production. Self-interested states all benefitted from the main rationale for the organisation's existence. Cooperation between the major oil companies and host states between 1973-1979 helped stabilise prices. Growing world demand also helped. OPEC had effectively managed prices in 1975 and in 1977-78 when demand had been slow.[75] But its ability to manage prices depended on its market share which had been considerably eroded by non-OPEC production.[76]

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[71] Robert Axelrod and Robert O. Keohane, "Cooperation under Anarchy: Strategies and Institutions," World Politics 38 (1985) 226-54.

[72] Susan Strange, "Cave Hic Dragons! A Critique of Regime Analysis," 36 (1982) 479-96; Robert Gilpin, US Power and the Multinational Corporation: the Political Economy of Foreign Direct Investment (New York: Basic Books, 1975).

It was the short-term actions of OPEC's member countries from 1979-81 that led to the disintegration of the market. OPEC undermined its own interests.[77] So focussed were the oil-exporting countries on preventing the transnationals from making windfall profits that they forgot about their own long-term interests. Reacting to short-term market conditions from 1979-81 OPEC governments did not act in concert. But the organization had by no means come into existence to entrench an order to suit the needs of the transnational corporations although they gained disproportionate benefits as free riders. This is what OPEC had moved to stop from 1979-1981. But OPEC members had also individually and in concert taken measures to maintain price and production discipline. By mid-1980 all OPEC members had imposed formal or informal ceilings on their production capacity, which brought OPEC's output to 27.8 million bpd, which was about 10 million bpd less than their total peak production capacity.[78] Since the March 1983 London agreement, OPEC countries had adhered more closely to OPEC discipline when members jointly agreed to reduce the price of the marker crude from $34 to $29.[79] Seymour comments that this would have been "tantamount to treason in the previous decade."[80] The 1986 price slump subdued OPEC, creating a realisation among member countries that there were severe costs for cheating.

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[73] R. Mabro, "Oil Prices in 1983: A Critical Year (1982)," in OPEC and the World Oil Market ed. Mabro (Oxford: Oxford University Press, 1986), 92.

[74] Ibid.

[75] Ibid.

[76] Ibid.

[77] Ibid., 98.

But there had always been the problem of free-riders within the organisation and outside it. Mancur Olsen, whose work forms part of the rubric of work on liberal collective goods and public choice theory, writes in his Logic of Collective Action:

> Though all the members of the group have a common interests in obtaining this collective benefit, they have no common interest in paying the cost of providing that collective good. Each would prefer that others pay the entire cost and ordinarily would get any benefit provided whether he [or she] had borne part of the cost or not.[81]

Saudi Arabia bore a disproportionate burden of the costs as the "swing supplier". Smaller producers gained disproportionately. There were OPEC's non-compliant members who cheated for short-term gains. In May and June 1982, several member governments began rule disobedience by undermining OPEC's Vienna production and price structure.[82] Non-OPEC producers gained without making any contribution to maintain price stability. Of course they could argue that as former consumers of OPEC they had already paid a heavy price. Indeed, since their main concern was to enhance market share at the expense of OPEC, their interests conflicted with those of OPEC members. The transnationals too had become free-riders - maximising their profits when prices were high and turning to the free market for oil when prices were low.

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[78] Seymour, Instrument of Change, 210; see also Louis Turner, 202; Louis Turner, Oil Companies in the International System 3rd ed. (London: George Allen & Unwin), 1983.

[79] Seymour, "Structural Change," 71.

[80] Ibid, 70.

[81] Mancur Olsen, The Logic of Collective Action: Public Goods and the Theory of Groups Harvard Economic Studies, Vol. CXXIV (Cambridge, Mass.: Harvard University Press, 1971), 21.

During the 1980s cooperation was necessary among more than merely the members of OPEC. Non-OPEC producers and transnationals were significant actors whose actions undermined market stability. Joint consultation among the major players in the market could bring market stability of which there has been some evidence in recent years. Ultimately, it is market stability, not vertical integration, however it is achieved, that will prevent the erosion of the host government's tax base and their bargaining power with respect to the transnationals.

Section III

The 1990s are being lauded as an era of peaceful co-existence between host governments and foreign investors.[83] Some scholars are repeating Kindleberger's 1969 observation that "the nation-state is just about through as an economic unit."[84] For some analysts, this era of peace is the product of increasing globalisation and hence, of the weakness of host governments. For others, such as myself, global structural changes have combined with some irreversible changes in host government/foreign investor relations to bring about this change. According to the bargaining "balance of power" model, bilateral negotiations between states and transnationals have swung irreversibly in favour of host governments, producing a new and more equitable distribution of gains - and with it a new stability. This does not mean that host government's will not bargain with the transnationals. Newfarmer argues that host governments are likely to bargain vigorously with transnationals for "a greater share of gains from their activities and for changes in their behaviour."[85] Obsolescence has become an accepted part of host country/foreign investor relations. Now the aim of foreign investors is to prevent rapid obsolescence rather than to stop it.

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[82] Mabro, "Oil Prices," 98.

[83] See for instance Sanjaya Lall, Multinationals, Technology, and Exports: Selected Papers (New York: St. Martin's Press, 1985), 66.

Several factors have contributed to rapid obsolescence.[86] The same forces are working to disperse the belligerence that provided the impetus for obsolescence.[87]

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[84] He had further argued, "General de Gaulle is unaware of it as yet, and so are Congress of the United States and right-wing know-nothings in all countries." Charles P. Kindleberger, American Business Abroad: Six Lectures on Direct Investment (New Haven and London: Yale University Press, 1969), 207.

[85] For an elaboration of this argument see Richard S. Newfarmer, "Multinationals and Marketplace Magic," in The Multinational Corporation in the 1980s ed. Charles P. Kindleberger and David B. Audretsch (Cambridge, Mass.: M.I.T. Press), 182-3.

[86] For a discussion of hastened obsolescence because of techno-globalism see for instance Sylvia Ostry, "The Domestic Domain: The New International Policy Arena," Transnational Corporations 1, no.1 (February 1992), 7.

[87] R. Vernon, "Sovereignty at Bay: Ten Years After," in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. Theodore H. Moran (Lexington, Mass.: Lexington Books, D.C. Heath, 1985), 257. Republished from International

Governments have become more knowledgable; they have more alternative sources of capital, technology and markets. Instead of nationalising the transnationals, host governments have utilised their increased bargaining power to maximise the benefits from the corporations. "Since they are less threatening, they are less feared."[88] Raymond Vernon captures the essence of this changing environment:

> The tumult of the 1970s over the multinationals issue has lost some of its stridence. The incidence of nationalisations in developing countries has declined dramatically. Kolko, Williams, Barnet and Muller seem a bit jaded. The U.N. Centre on Transnationals Corporations has developed a business-like air, more akin to the professionalism of the Securities and Exchange Commission than to the prosecuting fervour of the Church Committee.[89]

Nye correctly comments that while the new era reflects the increased bargaining power and knowledge of governments, it also demonstrates that the predictions of a continuous decline in corporate power, a common theme in the 1970s, were overstated.[90] Few developing countries have completely disassembled the regulatory edifice for controlling transnationals. The dismantling has primarily been directed towards easing bureaucratic constraints on the transnationals' operations. The removal of restrictions on the transnationals' activities constituted one of the most fundamental trends in the 1980s. A 1985 United Nations survey of 46 countries shows that there were

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Organization 35 (Summer 1981), 517-530.

[88] Ibid., 257-8.

[89] Ibid., 257.

[90] Joseph S. Nye, Jr., "The Multinational Corporation in the 1980s," in The Multinational Corporation in the 1980s ed. Charles P. Kindleberger and David B. Audretsch (Cambridge, Mass. and London: The MIT Press, 1983), 2.

more than 300 changes in the regulatory environment for foreign investors.[91] But governments still evaluate the costs and benefits of specific investment proposals and continue to intervene. As long as the state as an institution persists, it will be permanently entangled in economic decision-making although its role has changed and will continue to change.

Although economic nationalism remains a handy tool, states use it sparingly. Host states have obtained other powerful tools, technological and economic tools that are utilised to communicate and negotiate with the oil companies in their own language. The bargain has become technical, "business-like," less confrontational and more pragmatic as host government bureaucrats have become more dexterous in utilising their knowledge and understanding of the industry's technical aspects. Flexibility has been introduced into contracts.[92] In the interests of joint-maximisation, foreign investors and the host government can negotiate changes in contract terms so that it is not a zero-sum game for either party.

When a foreign company participates in the host country's oil industry, the government's share depends on the bargain that it can strike with new or incumbent oil companies. The oil company runs the industry; the host state furnishes the raw materials. Both parties seek to maximise the industry's long-term profitability. The interests of the two parties differ in that while the host country seeks a gainful growth of its oil industry, the companies will invest in countries that offer the highest returns on capital. Both parties have some powerful bargaining resources so that the negotiations occur on an even keel.

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[91] UNCTC, World Investment Report 1991: The Trend in Foreign Direct Investment (New York: United Nations, 1991), 28.

[92] Roland Brown, "Contract Stability in International Petroleum Operations," The CTC Reporter no. 29 (Spring 1990), 56; United Nations Centre on Transnational Corporations, Transnational Corporations in World Development: Trends and Prospects (New York: United Nations, 1988), 314.

In chapter 4 I discussed the issue of fairness in greater detail. To reiterate the basic argument, the bargain is not really one of fairness but of a supply price between two bilateral monopolists with different bargaining resources. In realist terms, it is a reflection of relative power resources and how they are utilised to produce favourable or not quite so favourable outcomes. In the Indonesian case, in this encounter the bargain was about a reasonable rate of return for the firm. The disputed issues in this bargaining encounter between the Indonesian government and the transnational oil companies - commerciality, new field incentives, incentives for deep-water drilling, were about how the state had eroded the profitability of the foreign firm and what it could do to redress the transnationals' complaints and bring greater "equity" in its relations with them.

The bargain was also about how the Indonesian government could reconcile two interests - maximum rent collection and optimum development of oil resources - that states hope to achieve when they develop the industry with the aid of transnationals. To reconcile these two interests the state must address the issue of the supply price and must offer transnationals a minimum rate of return that will make their investments lucrative. As Muchlinski notes, in the 1980s the key bargaining issue between host governments and foreign investors was not about ownership but about the division of revenues between the company and the state.[93]

In a 1983 report, the U.S. based consulting agency, Mihaly International Corporation recommended joint-industry action to persuade the Indonesian government to reconsider the terms and conditions of the production-sharing contracts under difficult economic conditions.[94] In this round of bargaining the oil companies pressured the government through the Indonesian Petroleum Association which had established an ad hoc committee in 1984 to address the question.[95]

Taking full advantage of the oil price slump in the midst of contract extension negotiations, the oil transnationals asked for contract revisions. The transnationals wanted to re-negotiate large parts of the production-sharing contract: they sought allowances for easier depreciation, fringe benefits, investment credits, and the re-negotiation of income tax rates and commerciality. They insisted that for tax purposes oil prices should be based on existing market conditions, not the government selling price.

Corporations are in the business of making profit and do not consider it their obligation to safeguard the public interest. If the state must subsidise its consumers, then its state enterprise must bear this burden. This is one of the functions of state enterprises - to perform functions that the transnationals are unwilling to bear. The oil transnationals in Indonesia wanted the government to end the ridiculously low price - U.S.$0.20 per barrel for the domestic marketing obligation by bringing it in line with market prices.

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[93] Muchlinski, "Law and the Analysis," 151.

[94] Unpublished document, Mihaly International Corporation, New York, 1983.

[95] For a spate of company commentaries on government policy see Caltex Pacific Indonesia, "Encouraging Foreign Investment in Indonesia," 26 November 1986; Confidential company memorandum, n.d., received by author, 2 July 1987; Diamond Shamrock, "Recommendations for Improving the Efficiency of Production-Sharing Contracts," Indonesian Petroleum Association, Jakarta, 1986; Letter from ARCO to Pertamina's President-Director Ramly, 14 November 1986. These views were reiterated in interviews with author. Chairman, Managing Board, major oil company, interview by author, Jakarta, 5 January 1987. Vice-President Finance, independent oil company, interview by author, Jakarta, 25 April 1987. Corporate executive, major oil company, interview by author, Jakarta, 6 March 1987. Corporate executive, independent oil company, interview by author, Jakarta, 26 March 1987.

The oil companies argued that Sekneg was paying less attention to technology and quality than costs and that Indonesianisation should be pursued in conjunction with efficiency, not at its expense. They sought the freedom to hire their own sub-contractors. They demanded an end to Sekneg's regulatory role in procurement decisions and a reduction in the BKKA's involvement to post-production expenditures in which it participated.[96] The oil companies felt that the government was taking advantage of its position as owner of the natural resource. They utilised the "contract sanctity" argument rather unsuccessfully: the government was undermining the business nature of the contract by forcing them to accept unequitable terms.

The oil transnationals co-related the harsh fiscal regime in Indonesia to the government's problems: depleting reserves, declining production, and falling exports and revenues. They attributed Indonesia's declining production to the absence of major discoveries and limited geological opportunity. They wanted the state to eliminate the ring-fencing system - the system that prevented them from consolidating the losses from dry holes with the profits from productive wells.

The transnationals disapprovingly noted that exploration incentives had been denied for several new fields which would have been received under standard industry definitions.[97] The industry claimed that the BKKA's refusal to grant commerciality and to give incentives for new fields for long periods was cutting into their profitability. If future fields yielded less oil, the government would have to reconcile itself to receiving less than 50 percent of production in revenues. Mobil for instance, which had signed a deep-water drilling agreement in 1978 when the price of oil hovered around the U.S.$13-15 range, argued that it could only guarantee the government 10 percent of cumulative production at 1986 prices.[98]

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[96] Petromin, October 1985, 32.

> Currently the profitability of hitting a discovery with huge reserves is small. Many of the fields that have been discovered recently have reserves of 40-50 million bpd. Some fields only have 30 million bpd. They might be commercial at $30 a barrel, that is the government may get 50 percent of production, but at current prices it is not commercial. The government has to introduce more flexibility and must increase the incentives.[99]

The oil-exporting governments had developed a variety of prices such as the tax reference price, government or official selling prices to bring stability to their oil earnings. First, these prices would curb transnationals from maximising their transfer pricing gains.[100] Second, with such prices their bargaining position with respect to foreign buyers would increase - the oil price for buyers would not constantly be subject to negotiation and haggling.[101]

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[97] Caltex Pacific Indonesia, "Encouraging Foreign Investment in Indonesia," (unpublished), 26 November 1986; Confidential company memorandum, n.d., received by author, 2 July 1987; Diamond Shamrock, "Recommendations for Improving the Efficiency of Production-Sharing Contracts," Indonesian Petroleum Association, Jakarta, 1986.

[98] Corporate executive, major oil company, interview by author, Jakarta, 10 February 1987.

[99] Chairman, Managing Board, major oil company, interview by author, Jakarta, 5 January 1987.

[100] Kameel I.F. Khan, "Petroleum Taxation and Contracts in the Third World - A Law and Policy Perspective," Journal of World Trade 22 (1988), 74.

The continued use of the government selling price or official selling price, which became an artificially high price in the 1980s, was reminiscent of the late 1950s when the oil-exporting countries refused to allow the transnational oil companies to reduce posted prices despite the real market price of crude. It did not matter whether the host state marketed its own crude or whether the international oil companies continued to take their share into their own systems. Realised prices, in the sense of what they had been in the 1950s and the 1960s with their paraphernalia of intra-firm transfers and transfer pricing, had become a thing of the past. Official prices, even if they were negotiated with the international oil companies, were the thing of the present. For tax purposes, the international oil companies could no longer book any price.

The Indonesian government used the tax regime to compensate for low prices. Just as posted prices had represented no more than a method of calculating the oil producing countries tax payments in the 1960s when market prices began to fall,[102] so beginning in 1983 the Indonesian government's official prices became increasingly out of line with market prices and were merely the measure by which the oil companies were taxed. In early 1986, the government had adopted a price regime called the agreed market price which changed on a monthly basis and in which each contractor used a system linking its crude to a basket of crudes. But this system only allowed the government to tax the transnationals on the basis of realised prices which were extremely variable and caused havoc in its budget. So as prices began to strengthen and the government's budgetary concerns became paramount, it introduced a tax reference price that was similar to the posted price system of the 1960s. Of course, the oil companies could carry over their cost recovery to subsequent years.[103] But the oil companies found this system "intolerable".

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[101] Corporate executive, major oil company, interview by author, Jakarta, 13 July 1987; high-ranking government official, interview by author, Jakarta, 2 January 1987.

[102] Penrose, The Growth of Firms, 193.

Domestic constraints play a significant role in keeping a host state dependent on transnationals. But host governments are limited in the extent to which they can push the transnationals. The transnationals' services were essential to the oil development program of a host government that does not intend to pursue the entrepreneurial role, has spent minuscule resources on research and development, and would not obtain the services of the foreigner for a fee because it chose to utilise its revenues for other purposes. For the Indonesian state which fitted this bill, the costs of doing without the services of the foreigner were prohibitive. It had been unable and unwilling to climb the learning curve to erode their firm-specific advantages entirely. Indonesia's geological structure combined with the government's lack of capital had kept the government dependent. Rapid depletion has always been a problem with Indonesian fields. Consequently, continuous expansion was essential.[104]

When corporate managers believe that the firm's discounted rate of return is threatened, they will resist continued incursions on their profitability. The Indonesian government could not postpone the day of judgment unless it chose to undermine its commitment to joint-maximisation and the future viability of the industry. Unlike the 1960s when the oil companies enjoyed fat profit margins, there was less to extract in the 1980s unless the host government chose to make the transnationals' operations unprofitable, since host governments had already pared the oil companies' profits significantly.

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[103] U.S. Embassy, The Petroleum Report: Indonesia (Jakarta: U.S. Embassy, 1987), 46.

[104] G. Vernon Hough, "Indonesia: Production Cuts Hit Development," Petroleum Economist, June 1982, 249.

The transnationals were not powerless.[105] Transnationals do have certain bargaining resources at hand. Even when they cannot make a credible threat to withdraw, they can employ punitive treatment against the host government by withholding the firm-specific assets that host governments require.[106]

Vernon argues that when the technology of an industry becomes more intensive, the firm's initial advantages are restored.[107] After the second oil shock, Louis Turner had argued that the oil majors would be able to avert extinction by remaining at the frontiers of technological innovations in the industry. Indeed, this would be their prime future role.[108]

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[105] For the continued dependence of Third World states on transnationals corporations see Thomas Walde, "Third World Mineral Development in Crisis," Journal of World Trade Law 19, no.1 (January-February 1985), 3-33.

[106] Douglas Bennette and Kenneth Sharpe, "The World Automobile Industry and Its Implications," in Profits, Progress, and Poverty: Case Studies of International Industries in Latin America ed. Richard S. Newfarmer (Notre Dame: Notre Dame Press, 1985), 222.

[107] Raymond Vernon, "Transnational Corporations: Where Are They Coming From, Where Are They Headed?" Transnationals Corporations 1, no.2 (August 1992), 26-7; see also Howard L. Lax, State Companies: Political Risks in the International Oil Industry (New York: Praeger, 1988), 193; See Susan Strange, "Big Business and the State," Millennium Journal of International Studies 20 (Summer 1991), 245-50; Stephen J. Kobrin, "Testing the Bargaining Hypothesis in the Manufacturing Sector in Developing Countries," International Organization 41 (Autumn 1987), 609-638.

Compared to the 1960s, when the technological barriers for primary oil production erected by the large international firm were eroded by independent companies and host governments, since the 1970s, with the depletion of primary oil fields, technology in the oil industry had become more dynamic because of the need to develop cheaper techniques to produce more vexing oil - the techniques to extract oil from deeper wells and through secondary and tertiary recovery. According to one estimate, the average cost of recovering a barrel of oil through secondary recovery techniques in 1988 dollar-terms ranged between US$10-25. The industry was seeking to reduce costs by 30-50 percent in the long-term.[109]

This cost-cutting technology would be developed within the huge research and development wings of the large and not so large integrated firms - the forerunners of technological innovations in the industry.[110] The host state, the main recipient of profits from any oil produced would be the main beneficiary of these cost reductions. But to recover the costs it has expended on developing these techniques, the international firm expects a larger reward than it is willing to accept for primary oil production.[111] Thus even if the host state pays a higher supply price to the transnationals initially, it can achieve considerable cost-savings in the longer-term. This factor must be included in the host country's calculations.

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[108] Louis Turner, Oil Companies in the International System 3rd ed. (London: George Allen & Unwin, 1983), 233-5. He notes the important role that the transnationals were already playing in deep-water drilling and secondary and tertiary recovery. "Once one moves into hostile environments such as the Beaufort Sea off Canada, where an offshore wildcat can cost US$40-50 million, one has moved into territory which is distinctly unfavourable to small, inexperienced companies." Ibid., 233.

[109] Peter Desprairies, "Oil Pricing and Alternative Energy Sources," Twenty-Fifth Symposium on "Geology Petroleum Markets," organised by the National Conference on Earth Science, 7 October 1988, tables xi-xii.

[110] High-ranking government official, interview by author, 15 September 1986.

[111] Ibid.

In Indonesia, as elsewhere, the majors, not the independents, had initiated the process of deep-water drilling in the early 1970s. In 1973 Mobil had begun deep-water drilling in Indonesia's Macassar Strait with an average depth of 1000 meters.[112] "Clearly, the whole of Southeast Asia's sedimentary basins had come within the ken of the international oil companies."[113]

In the late 1980s a reduction in development costs was already underway. For instance, the Indonesian Anoa field that was estimated to be developed at a cost of $5-6 per barrel when it was discovered in the early 1980s, was under development at a cost of $3.20 per recoverable barrel - the result of engineering re-evaluations, technological developments, and cost-reduction. During 1987-1988, field development costs had been reduced by 39 percent in the UK North Sea.[114]

Although the transnational cannot make a credible threat to withdraw when its existing investments are promising and profitable, it can make credible threats to reduce its activity and to reduce future corporate spending. It can make a tenable threat that its parent company will not allocate sizeable future budgets to the subsidiary if it consistently underspends its previous budgets. For then, other rewarding opportunities will be found. The transnational can also make a credible threat that the surplus revenues from one year's budget will not be carried forward to the next year. The host government that is interested in maintaining a high level of investment activity within its jurisdiction must take such threats seriously.

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[112] Petroleum News Southeast Asia, July 1973, 34.

[113] Leon Howell and Michael Morrow "Looking for Oil In Vietnam," in Asian Oil Politics and the Energy Crisis ed. Leon Howell and Michael Morrow (New York: International Overseas Documentation Centre, 1974), 125.

[114] John Wood Collins, "Non-Opec Output Likely to Rise Significantly," Petroleum Intelligence Weekly, 6-7. These reappraisals were partially the product of reduced geophysical and drilling costs, the outcome of increased competition among oil supply and service firms. Ibid.

In the 1980s, these warning were plausible for two reasons. First, the world-wide recession had forced firms to trim their fat. The oil industry had been no exception. "Greenfield" investments had declined while rationalisations and mergers had become a common industry feature around the globe. Second, a well-worn strategy of the large international firm is to give priority to its global profitability, not to the health and continuity of its individual subsidiaries in national locations. Indeed, this has consistently been a sore point for critics of the transnational corporation ever since dependency became an academic and political message - that local interests are undermined or marginalised by the transnational's global mentality.[115]

Transnationals are in the business of making profits. To assess the viability of a petroleum project, its profitability is measured in terms of the discounted cash flow rate of return on invested dollars; this is a financial evaluation based on risk-related discounted cash-flow analysis.[116] According to a 1982 United Nations assessment, the discounted cash flow rate hovers around 25-30 percent.[117] If a company invests all or most of the capital for exploration and development it expects to recoup a higher rate of return on its investments including costs. When geological, economic, and political risks are high, they are factored in to produce a higher discount rate. The host country can only negotiate these expectations down if it can offer promising geological probabilities or a bonanza.[118]

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[115] See for instance, R. Barnet and R. Muller, The Power of the Multinational Corporations (New York: Simon & Schuster, 1974), Chapter 10.

[116] Khan, "Petroleum Taxation," 68.

Many of the Indonesian production-sharing contracts were coming to an end and, as I argued in my discussion regarding Caltex's contract extension in the last chapter, firms are unwilling to expend large sums of money in the last years of their contract period unless they can expect future rewards to match their efforts. In the Indonesian case, this implied contract extension. From the transnational's perspective, sinking money into an enterprise that will not bring a reasonable rate of return in the future, is a fatal decision, a decision that throws the idea of discounted cash-flow calculations to the winds, and that no corporate manager in his or her right mind would undertake. Firms will seek to maximise their discounted cash flow. One oil executive working for an oil major in Jakarta commented:

> The production-sharing contractors are guilty of erring on the high side i.e optimising the rate of return. In a way you cannot blame them since they have very little in the way of positively estimating what the actual return should be. It depends on a whole host of factors - the oil price, the number of wells drilled, whether there will be secondary or tertiary recovery or whether the contractor will rely on primary recovery

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[117] United Nations, Alternative Arrangements for Petroleum Development (New York: United Nations, 1982) cited in Khan, "Petroleum Taxation," 68.

[118] Ibid.

techniques like a simple water flood.[119]

Economics alone does not determine a reasonable discounted cash-flow for the firm. Perception also plays a significant role. An executive of another oil major astutely explained:

> Many transnationals that entered the Indonesian market until 1978 had conducted their risk/reward assessments on the basis of a barrel of oil that would fetch $14.00 or less. But when oil prices rose to $35.00 in 1980, their perceptions of what constituted a "reasonable" rate of return changed dramatically. Consequently, when oil prices crashed to $10.00 a barrel in 1986 the oil companies concluded that their operations were unprofitable and that the government should compensate them.[120]

The oil companies brought their bargaining resources to bear. The foreign oil companies argued that their "limited investment funds" would only be allocated when the issues of bureaucratic delays and the stalemate about commerciality, the consolidation of profits and losses, a clear definition of new fields, the domestic marketing obligation, and taxation were resolved.[121] Arco's Chief Executive Officer, T.N. Macmud noted that from 1981-1987 the industry had underspent its budget by an average of 26 percent "largely due to project delays."[122] This view was re-affirmed by Caltex's Managing

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[119] Corporate geologist, major oil company, interview by author, Jakarta, 2 March 1987.

[120] Corporate executive, interview by author, Jakarta, 10 February 1987.

[121] Corporate documents, major oil company, dated November 14 1986 and November 26 1986.

[122] Jakarta Post, 8 June 1988; During 1986, actual spending by all foreign oil companies was 33% below plans. The total budget for 1987 was 32% lower than the 1986 budget. U.S. Embassy, Indonesia's Petroleum Sector (Jakarta: U.S. Embassy, 1987), 38. See also "Spending Cuts Dim Bright Spot in Southeast Asia Pacific Activity," Oil and Gas Journal, 4 August 1986, 16-17. For Abdul Rachmat Ramly's acknowledgement to House of Representative's that seismic surveys had declined to 28, 734 kilometers in 1986 from 54,000 kilometers in 1983 see The Jakarta Post, 9 February 1987.

Director, Haroen Al Rasjid.[123] They both warned that their parent companies had already begun to reduce budgetary allocations for Indonesia.

But the Indonesian state was not without bargaining resources. The downturn in oil prices did not render the Indonesian state powerless or deprive it of bargaining resources. The state bided its time to determine whether the oil price decline was a short-term cyclical phenomenon or a long-term structural change. A host state derives its leverage with respect to transnationals from its location-specific advantages. Several factors enhance its leverage in a natural resource industry. The state's leverage increases when corporations have sunken investments and they find the future prospects of finding oil in the host country sufficiently attractive. Corporations tend to succumb to host government demands when the political risk factor in the host country is low and the government offers a "pragmatic" rather than a confrontational and hostile bargaining milieu to foreign investors. The state's leverage is enhanced when companies do not threaten withdrawal and there is a high success ratio in oil discovery. The state's bargaining hand is strengthened when parent companies continue to allocate large budgets to the host country despite the downturn in the international prospects of the industry and they are eager to extend their contracts.

When such factors favour the host government, it need not concede blanket concessions to the transnationals or respond to their demands immediately. State managers can test the waters to keep the supply price to the minimum without undermining an active oil and gas exploration program. The entry of new investors is a good measure, for at that point the host government can assume that the investment climate is sufficiently attractive to prompt incumbent investors to conduct an active exploration program.

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[123] Speech by Haroen Al Rasjid, Chairman, Managing Board, Caltex Pacific Indonesia, cited in Jakarata Post, 7 November 1986.

As a forum enabling the oil-exporting countries to increase their share of oil revenues, OPEC had been extremely effective. OPEC governments adhered to the principle that even if market prices fell below posted prices, the latter would not be reduced. In practice, the income tax was transformed into an excise tax. The net profit share of oil-exporting countries gradually reached 85 percent with the aid of a gradually ascending tax and a descending price.[124] The hitherto powerless oil-exporting countries had learnt to bargain with the large oil companies.

Before the 1971-1973 OPEC revolution, the transnational oil companies determined the "fair share" of profit for the oil exporting countries. The host government had to fight, confront, cajole and threaten the transnational firm to relinquish a larger share of its profits. Now the host government was the ultimate arbiter of the transnational's profitability within the limits set by its own need for the transnational's services. It had the expertise to calculate a "reasonable rate of return" for the company based on "established industry practice" that was never in the 50-80-100 percent range as had been the case for most oil-exporting countries during the first seven decades of the twentieth century. With oil prices at an ebb, high government revenues were the bone of contention and it was the transnational's turn to cajole, confront, and threaten the host government to concede a "reasonable" rate of profit.

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[124] Morris A. Adelman, "The Multinationals in the World Oil Market: The 1970s and 1980s," in The Multinational Corporation in the 1980s ed. Charles P. Kindleberger and David B. Audretsch (Cambridge, Mass. and London: The MIT Press, 1983), 123-138.

The Indonesian government had a long memory that it had developed over the years. The bureaucracy remembered those earlier risk/reward assessments of the oil companies. Pertamina made its own estimates about a reasonable rate of return for the foreign investor.[125] Consequently, Pertamina and Migas state managers were not overly worried about the oil companies' complaints in the short-term.[126] Although the companies complained about bureaucratic problems and the government's "unfair" over-priced official selling price, the oil companies still found the Indonesian market sufficiently attractive to stay and await more favourable outcomes.[127]

Sunken as their investments were, the oil transnationals could not do much to change the Indonesian government's chosen pricing policies, its commitments to OPEC which it consistently used to strengthen its hand with respect to the transnationals or its allocation of production-cuts to the transnationals, other than threaten to cut production and budgets, and grumble. In the short-term, they were forced to accept the tax regime and to comply with it.

Transnationals cannot make a credible threat to withdraw when they derive all or most of their profits from the host country. The state can then call their bluff. Several independent companies made virtually all their profits in Indonesia.[128] In 1986 Chevron, Mobil and Texaco derived more than half their upstream profits from their Indonesian operations.[129]

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[125] High-ranking government lawyer, interview by author, Jakarta, 12 December 1987.

[126] In mid-1982 Wijarso told the Oil and Gas Journal that Indonesia offered "fair and equitable incentives" and that "it remained an attractive oil and gas depository." Oil and Gas Journal, 14 June 1982.

[127] Ibid.

This was Indonesia's saving grace. The oil companies' parents were still allocating sizeable budgets to their Indonesian subsidiaries.[130] A transnational corporation does not allocate its resources to maximise the health of its subsidiaries but to maximise its world-wide profitability. Each opportunity is appraised with respect to opportunities available elsewhere. Accounting for factors such as accessibility to key markets, transportation costs, tariffs, taxes, and political stability the transnational allocates its monies annually to ensure the highest global rate of return. It is concerned with opportunities that will maximise the growth of the firm, world-wide profits, and ways to balance market demand with sources of supply. The transnational views the entire world as its market and as a source for its product.

Despite the availability of adequate crude supplies on the open market and their propensity to treat their downstream operations as "stand-alone" businesses, the oil majors continued to seek vertical integration as far as possible. Vernon argues that this was not because of the disadvantages faced by firms in unfamiliar markets as Hymer had once noted. Instead, it stemmed from their pre-World War II motives for integrating. They continued to seek vertical integration to counter substantial uncertainty in oligopolistic markets because of the "predatory" and "preemptive" strategies pursued by their oligopolistic competitors.[131] Indonesia, where the production-sharing contract gave the transnationals a guaranteed flow of supplies for their downstream operations, was one of the few countries where this was possible.

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[128] U.S. Embassy, The Petroleum Report: Indonesia (Jakarta: U.S. Embassy, 1985), 58.

[129] Petroleum Intelligence Weekly, 31 August 1987, 2-3.

[130] Ibid.

The transnationals had other incentives to stay in Indonesia. Political and commercial risks were low, factors that figure largely in corporate decisions to invest in a host country and for which the host government can extract a larger share of rent. The discovery ratio of finding oil per wells drilled had improved - 1:2 in 1986 compared to 1:7 in 1970.[132] Caltex complimented the Indonesian government for its low political risk environment.[133] Husky praised the Indonesian government for its pragmatism.[134] In the midst of crashing oil prices, Mobil promised to increase its oil and gas exploration budget by 23 percent.[135]

Past performance and future promises of active exploration and development are significant criteria for contract extension.[136] Indeed, it is argued that performance requirements have played a significant role in diffusing the tension between transnationals and host governments.[137] Performance requirements constitute a powerful instrument in a host government's store-house of economic nationalist demands to which transnationals have been forced to succumb to maintain their profitability.[138] In 1991 the United Nations revealed that, based on a survey for 1977-1987, despite an overall increase in liberalisation during the 1980s, the industrialising countries had increased performance mandates and sectoral limitations in strategic industries.[139] Indeed, contract extension has become a major bargaining card for host governments. It enables the host state to partially neutralise the bargaining advantage that transnationals derive from making new investment commitments. Now the host governments earlier insistence on shortening the transnationals' contract period began to bear fruit.

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[131] Raymond Vernon, "Transnational Corporations: Where are They Coming From, Where are They Headed?" Transnational Corporations 1, no.2 (August 1992), 26-7. Also see "Why Kings of Crude Want to be Pump Boys," Business Week, 21 March 1988, 110-112, cited in ibid.

[132] High-ranking government official, interview by author, 15 September 1986; for 1986 ratio see also Petroleum Intelligence Weekly, 31 August 1987, 2-3.

[133] Caltex Pacific Indonesia, "Encouraging Foreign Investment in Indonesia," Jakarta, 26 November 1986.

[134] R.J. Blair and Menno Weibe, "An Exploration Strategy for Indonesia," unpublished Husky Oil document, March 1985.

[135] The Jakarta Post, 23 November 1986. Of course, Mobil was one of the few producers that benefitted from the host government's adherence to the government selling price during the 1986-1988 period because L.N.G. was sold at that price.

[136] Opec Bulletin, April 1989, 50.

Host governments introduced shorter contract periods in the 1950s and the 1960s to re-affirm the state's ownership and control over its natural resources. During the first half of the 20th century, the 75 to 99-year concession agreement had played an integral role in keeping host governments at the mercy of the large international firm. Host governments could not retrieve the concession, reduce its extent, or its duration which gave the concessionaire complete control over the operation, and over production, pricing, and marketing.[140]

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[137] "Transnational Corporations in the Early 1990s," The CTC Reporter (Autumn 1988), 53.

[138] T.H. Moran, "Multinational Corporations and the Developing Countries: An Analytical Overview," in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. T. H. Moran (Lexington, Mass.: Lexington Books, D.C. Heath, 1985), 9.

[139] United Nations Centre on Transnational Corporations, Government Policies and Foreign Direct Investment (New York: United Nations, 1991), 10-12.

Seeking to reduce the territorial control that the large international firm derived from the principle of the sanctity of private property, host states began to shorten contract periods. This allowed them to terminate the foreigner's contract, to extract better terms, or neutralise the foreigner's bargaining advantage when contracts were extended.

In Indonesia, incentives and contract extensions were contingent on performance - past and future. Many companies aspired to renew their contracts. So 1988 saw a flurry of drilling activity. Active work programs were promised if the state renewed their contracts.[141] In 1987, after four slow years, six new production sharing contracts were signed. Exploratory wells drilled increased from 82 in 1987 to 135 in 1988, although they still did not reach the 1983 of 264 wells drilled.[142]

The bargaining context had changed in this encounter. The bargaining outcome and the manner in which the negotiations were conducted reflected the new benign climate in the relations between transnationals and host governments and the relative power position of both parties. They bargained from a position of relative equality and neither was pushed to the extreme end of the bargaining continuum. Both parties brought some bargaining resources to the negotiating table. The oil companies had the technology and capital; the Indonesian government had attractive natural resources that had so far brought abundant profits to the firm. The Indonesian government also presented the oil majors with an opportunity to remain partially integrated.

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[140] Several excellent surveys of the oil industry provide good discussions of the early concessions. See Penrose, The Large International Firm; Penrose, The Growth of the Firm; Anthony Sampson, The Seven Sisters: The Great Oil Companies and the World they Made (London: Hodder and Stroughton, 1975).

[141] Letter from Arco to President-Director of Pertamina, 14 November 1986.

[142] U.S. Embassy, The Petroleum Report: Indonesia (Jakarta: U.S. Embassy, 1989), 26. See also Petroleum Intelligence Weekly, 5 June 1989, 2.

As the UNCTC notes, "The strongest evidence of changing attitudes comes from the natural resource sector where the innovative petroleum industry has taken the lead in devising new contractual arrangements to ensure a more flexible and pragmatic relationship."[143] A longish commentary derived from a UNCTC 1988 survey captures the essence of the new issues and bargaining framework between host governments and foreign investors affirms my conclusions with respect to the Indonesian case.[144]

Most industrialising countries do not have the financial and technical capacity to explore for and produce oil. Bleak market conditions demonstrated that host governments and transnationals would have to periodically re-adjust their contractual arrangements. Companies would not be willing to invest huge amounts of capital in exploration and development unless governments gave them specific statutory or contractual rights. But governments were unwilling to allow companies unconditional advance guarantees without clear and detailed investment programs. Thus commerciality had become one of the most contentious issues in bargaining between foreign investors and host governments. At the same time, governments had become more willing to make contractual concessions when market conditions threatened a reasonable rate of return for the firm. Governments no longer cared about equity. Their ultimate concern was to maximise their revenues from the project. As I demonstrated in the Indonesian case, the production-sharing contract was based on this very principle. Indeed, the UNCTC lauded the production-sharing contracts which provided the institutional framework for a continuous review process.[145] The United Nations' business-like approach that Vernon alludes to is demonstrated in the following statement: "Where substantial reserves have not been established or acreage might be regarded as speculative or untested, it is not unreasonable for companies to press for additional incentives."[146]

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[143] "Early 1990s", The CTC Reporter, 53; for a similar argument see also Vernon, "Where are they Heading," 13-14.

[144] United Nations Centre on Transnational Corporations, Transnational Corporations in World Development: Trends and Prospects (New York: United Nations, 1988), 322-26.

In Indonesia, both parties adopted a non-confrontational approach. Arco's President-Director conceded that the oil companies' internal accounting procedures and neglect of contractual obligations to Pertamina in the form of inadequate and skimpy accounts, had forced the state to impose a stringent regulatory regime. Arco's Managing-Director, T.N. Machmud conceded, "Our sins of the past in bringing all that production on as soon as possible while neglecting administrative details came back to haunt us with a vengeance."[147]

The Indonesian government recognised that the costs of doing without the services of the foreigner was high and that they would have to accept reduced revenues to maintain optimum production levels.[148] Subroto noted, "I would like to give the industry a message; that we are living in difficult times, but we should not just look at the short-term. The government is ready to listen and discuss what can be done about it."[149] Beginning in 1985 and through 1986 and 1987, the legal teams in Pertamina and the Ministry of Energy toyed with various alternative scenarios to improve the investment climate for the foreign oil companies while limiting the long-term costs to the government.

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[145] Ibid.
[146] Ibid., 324.
[147] Jakarta Post, 8 June 1988.
[148] Petroleum Intelligence Weekly, 31 August 1987, 2-3.

In this encounter, Migas and Pertamina agreed about the broad policy outlines in the oil industry. They agreed about Indonesianisation, maintaining the tax reference price, and a guaranteed revenue for the state from oil exploration and development. But Migas was more willing to give the transnationals a sympathetic hearing than was Pertamina.

Certain orientations become entrenched within certain state agencies and certain ministries. In Migas, the bilateral monopoly, rational-state approach had become entrenched. Pertamina housed more nationalistic state managers. The new Director-General of Migas and Wijarso's successor, Soedarno Martosewojo, also adopted the same approach. The BKKA remained more inflexible. Pertamina and Migas disagreed about whether the state should make up for the difference for the losses in the transnationals discount rate under changed market conditions and what that supply price should be.

There can simultaneously be unity and fragmentation within the state apparatus. For instance, there can be agreement about general policy but not about implementation. There can be agreement about a policy at one historical juncture but changing structural conditions in the international or domestic context can create a situation of fragmentation. One agency can question the reasonableness of a policy and ask whether it is in the national interest to implement it in quite the same way under changed circumstances. But these changed interests do not necessarily imply that transnationals have captured that section of the state apparatus because the agency that is willing to compromise with the transnationals is also willing to bargain vigorously with them.

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[149] Petromin, October 1985, 36.

The changing government policy on commerciality provides evidence for a number of interesting observations about host government/foreign investor bargaining. First, this case demonstrates the limits within which the dependent state bargains. The state will not allow specific sections of the state apparatus such as its state enterprises to threaten long-term accumulation goals. As I demonstrated in the last chapter, transnationals will ally themselves with those sections in the state apparatus that are willing to bring the recalcitrant agency to book. Second, it shows how government pressure on the oil companies to reduce exploration and production costs forces transnationals to innovate and to develop cost-cutting technologies. That is, governments do and will bargain with transnationals to obtain their services at more competitive prices. Third, while the dependent state must make some compromises with the transnational oil companies, bargaining is still viable. The state gives incentives selectively, not across the board.

Under the leadership of Ir. Wijarso, the Ministry of Mines had consistently argued for greater flexibility on the commerciality issue. Wijarso was unwilling to sacrifice the state's absolute revenues in the longer term. He believed that it was advantageous to raise the supply price paid to the oil companies to hasten immediate extraction and development of the resources in the ground. However, under the leadership of Warga Dalem, a staunch economic nationalist, the BKKA's state managers believed that it was worthwhile to postpone immediate extraction because of the potential revenues that the state might earn in the future. Ultimately, the dispute between the BKKA and Migas was about the discount rate: whether the discounted profits earned immediately exceeded the alternative discounted profit that could be earned by transferring the units of extraction to other time frames.

But even if the Ministry of Mines took a more sympathetic view of the oil companies' position, this did not mean that the Ministry had been captured by the transnationals corporations. Rather, the oil companies were able to take their complaints to the Ministry of Mines because of the prevailing perspective about oil policy in that agency. The BKKA position did not prevail. But the oil companies' perspective was also not accepted in toto. What emerged was a compromise deal. Indeed, the Ministry had come to serve as a mediating agency between the state enterprise and the oil companies.

Two commerciality cases made the oil companies extremely wary of the future prospects of producing oil in Indonesia - Gulf's Anoa field in West Natuna Sea and Arco's Sembuankang field in Kalimantan. Pertamina had allowed Arco to start producing oil when oil prices were high in 1981 but in 1983 it had declared that the field was no longer commercial.[150] After long-drawn out negotiations which Arco found completely unacceptable, Pertamina had required the company to return the field to Pertamina after cost-recovery. Gulf found oil in the Anoa field in 1983 but it was not until mid-1985 that

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[150] U.S. Embassy, The Petroleum Report: Indonesia (Jakarta: U.S.Embassy, 1984), 53.

Pertamina granted commerciality.

Warga Dalem had denied Gulf's request for commerciality on the basis that Pertamina could not expect 50 percent of total reserves.[151] The result of the two years of dragging negotiations between Gulf (now Chevron) and Pertamina was that like his predecessor Djack Zahar, Warga Dalem was relieved of his position because his inflexibility as a negotiator was seen to threaten the state's long-term capital accumulation goals.

The ultimate deal that was struck between Pertamina and Chevron was a compromise deal. Pertamina would get a guaranteed share of production even if the lower reservoir estimates proved to be correct. In an effort to obtain commerciality, Gulf agreed to recover its sunk exploration and capital costs over a longer time-frame.[152] The corporation agreed to use its best efforts to utilise cheaper technology to develop the field.[153] By 1988, as I mentioned earlier in this chapter, Chevron had indeed reduced production costs for the Anoa field by 50 percent.

The agreement with Gulf was the harbinger of a general reassessment of the commerciality issue within Pertamina and the Department of Mines and Energy. The government now emphasised that commerciality would be determined on the basis of specific conditions and the location of the block. The government would consider taking less that 50 percent of total production in remote frontier areas where both the risks and the costs were high. But the BKKA would still evaluate the contractors' production schedule and work program and evaluate the commercial value of a discovery independently.[154]

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[151] For a discussion see Petroleum News: Asia's Energy Journal, 1, 7.

[152] U.S. Embassy, The Petroleum Report: Indonesia (Jakarta: U.S. Embassy, 1985), 63.

[153] High-ranking government official, interview by author, Jakarta, 27 May 1987.

A similar approach was taken with respect to the oil companies' other demands. The Indonesian state did not grant concessions to the transnationals out of ignorance but because it recognised that a readjustment in the supply price was necessary in the context of changed structural conditions in the international oil market. The government recognised that the unknown waters in which it wanted the oil companies to venture would require a higher supply price than it had previously paid for more mature and well-known fields. That the state was willing to consider the transnationals' demands did not imply that the state had been pushed to the low end of the balance of power bargaining continuum. By now the Indonesian government had a team of experts that could negotiate with the transnationals in economic and technical terms. These bureaucrats could advise the government on how far to push the oil companies without forcing them into a position to make a credible threat to withdraw or curb active work programs. Government officials can bargain most effectively when they have specific information about the real rate of return to an enterprise and the technical skills to match that knowledge.[155] This well-versed bureaucracy understood industry practices enough to know when to maximise its gains and when to pull back and concede to those demands that it perceived to be legitimate and justified.

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[154] U.S. Embassy, The Petroleum Report: Indonesia (Jakarta: U.S. Embassy, 1985), 63.

[155] C. Vaistos, Inter-Country Income Distribution and Transnational Corporations (Oxford: Clarendon Press, 1974) 135-147; see also Richard S. Newfarmer, Transnational Conglomerates and the Economics of Dependent Development: A Case Study of the International Electrical Oligopoly and Brazil's Electrical Industry Contemporary Studies in Economic and Financial Analysis, Vol. 23. (Greenwich, Conn.: Jai Press, 1977), 12.

To minimise the losses to the Indonesian state, these well-versed bureaucrats had forced the oil companies to pay taxes on the basis of a tax reference price which was higher than the market price for Indonesian oil during the dark years of 1986-1988 when oil prices had hit the rock-bottom at $10.00 a barrel. Not aspiring to step into the oil companies' production shoes and having learnt the rather expensive lesson of the long-lead time that it takes to add reserves as the 1976-1981 period had demonstrated, several government bureaucrats argued that it was time to pay attention to the oil companies' reduced expenditures during the 1983-1987 period.

But once the foreigner has been squeezed to the point where its basic discounted cash flow is threatened, then the government cannot push further unless it takes over the oil industry itself. When changes in the domestic and international structure of the industry create the conditions for reduced profits for both bargaining parties, the dependent state must make concessions.

Ministry of Mines bureaucrats argued that government revenues per barrel could not be maintained at this higher level for long without obliterating the oil companies profits. When more rewarding opportunities await the firm, it is unlikely to continue an unprofitable venture. Indonesia's proven oil reserves were declining which implied that the country's oil output would also be significantly reduced. It was argued that the government must consider new incentives for the oil companies if it wanted them to produce oil from deeper wells, unknown and untried basins, and to employ the complicated and more expensive techniques of secondary and tertiary recovery. The short lives of the small Indonesian fields made it necessary for the government to maintain consistently attractive terms on a continuous basis so that high levels of exploration could be sustained to achieve stable output. It is from this knowledge, that the state wants them to pursue intensive oil exploration with sophisticated technology, that the oil transnationals derive their bargaining advantage.

The Indonesian government had come full circle.[156] It had experienced the shortcomings of the ceiling with the first generation of production-sharing contracts (1965-1975) which had afforded exorbitant windfall profits to the oil producing transnationals during the early 1970s. It had weathered the failings of unlimited cost recovery with the second generation of production-sharing contracts (1976-1988) under which the state would derive no revenues from the increasingly marginal field. For the third generation of production-sharing contracts (1988 onwards), a third solution was given consideration - the government would obtain a minimum revenue from the oil field before costs were deducted.[157] Wijarso argued that from the perspective of risk, the minimum guarantee requirement was superior to the cap because, as the 1973-1974 experience had demonstrated, the cap did contain elements of risk. "We do not want to take the risk. And the cap can work both ways."[158]

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[156] G.A.S. Nayoan, "Variations to the Indonesia Production-Sharing Contract: Impact of Upstream Exploration Activities," Paper presented at the 1989 Asian Production-Sharing Contracts Conference, Institute for International Research, Singapore, 30-31 May 1989, 2-3.

[157] Ibid.

[158] High-ranking government official, interview by author, Jakarta, 27 May 1987.

Government and corporate accountants and lawyers worked on solutions to the problem. While 50 percent of total production from marginal fields as a guaranteed share of income to the state defied commerciality decisions in many fields and was too high from a corporate perspective, the oil companies did not expect the government to define fields as commercial if it could not obtain a certain percentage of guaranteed income. The Indonesian government, the U.S. Embassy, and the oil companies - Mobil was at the forefront - looked for solutions so that the state could obtain a guaranteed income and the oil companies could bring fields into commercial production. In response to a query from James McGlinchy, the U.S. Embassy Petroleum Attache in March 1987, the I.R.S. cooperatively noted that the government could defer cost recovery "as long as it is not a permanent one."[159]

In 1987 Subroto promised to extend the Indonesian production-sharing contracts.[160] At the opening of the Indonesian Petroleum Association Annual Convention in Jakarta in October 1987 President Suharto reaffirmed this commitment on the grounds that the future development of the Indonesian oil industry:

> ...will require much capital, advanced technology and sophisticated management staff that we at present are in need of to some extent. We therefore invite foreign investors to participate in exploring to increase the nation's capabilities based on realistic and fair market benefits. ...the Government of Indonesia has basically approved extending production-sharing contracts existing under the present laws. ...the government will keep improving the investment climate to accelerate the development of the petroleum industry. The government also highly appreciates the production-sharing contractors who have always expressed a positive

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[159] Confidential documents, n.d received from major oil company, 2 July 1987. Telephone conversation with foreign diplomat, Jakarta, 14 May 1987.

[160] Corporate executive, independent oil company, 7 April 1987.

attitude, and we hope that this attitude can be maintained.[161]

But powerful entrenched interests within the state apparatus cannot be subdued. Sekneg's role in procurement was ended to streamline the bureaucratic process. But Suharto shifted one of Sekneg's most powerful members to the Ministry of Mines to carry on the nationalist agenda. In 1988, Suharto chose an economic nationalist as the Minister of Mines, Ginandjar Kartasasmita, who as the Minister of the Promotion for Domestic Products in Sekneg had given his staff the permanent authority to demand competitive prices from foreign companies and to ensure that they maximised local content. He was a strong supporter of import-substitution industrialisation and yet an eager champion of foreign investors who brought rich dividends to the state. He had a no-nonsense reputation, willing to play hard-ball but also to make compromises. He could be expected to implement the government's vision of promoting national content without undermining the transnationals' interests. He had demonstrated this capacity as Chairman of the BKPM in the textile industry as I will show in Chapter 11.

In 1987, the oil companies were no longer required to obtain approval for oil eqipment procurement for pre-production exploration activity although the regulation continued to apply to post-production procurement.[162] Minister Ginandjar announced two incentive packages for the oil companies in 1988 and 1989. Their production share was increased.[163] The production split was changed to 75/25 for deep sea drilling and to 80/20 on the first 50,000 bpd for normal contract areas over the prevailing 85/15 split.[164] Companies could access an additional investment credit for deep-sea drilling. The domestic marketing obligation price was changed from 20 cents a barrel to 10% below the export price.[165] The BKKA promised that commerciality decisions would not be linked to the minimum revenue requirement and that it would establish standard definitions of new fields and regularised criteria for investment credits.[166]

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[161] U.S. Embassy, The Petroleum Report: Indonesia (Jakarta: U.S. Embassy, 1988), 3.

[162] The Jakarta Post, 29 September 1987.

[163] Petroleum and Taxation Report (New York: Gordon Barrows), May-June 1989, 17; July-August 1989, 24-7. In 1989 the terms were changed again. The government

The oil companies were exempted from a controversial 10 percent value-added tax.[167] They were allowed to exploit territory that had previously been reserved for Pertamina.[168] Coinciding with the First Tranche Mechanism, the government accepted a lower guaranteed revenue - 20 percent instead of 50 percent - which made marginal fields more attractive to the transnationals because the definition of commerciality had been relaxed.[169] Procurement procedures for production-sharing contractors in the exploration-stage were modified, long-standing audit claims between many companies and the government were settled, and the government awarded commerciality to several

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increased incentives for enhanced recovery projects. The revised terms gave the contractors 20 percent of the oil produced through secondary recovery in fields of less than 50,000 bpd and for tertiary recovery and frontier areas. The 20 percent rule also applied to marginal fields of less than 100,000 bpd. For frontier areas that included offshore fields in water deeper than 600 feet and requiring enhanced recovery methods the companies obtained an even larger share of production. Petroleum Intelligence Weekly, 20 February 1989; Petroleum Intelligence Weekly, 29 February 1989. check p.nos.

[164] Nayoan, Variations," 3.

[165] Petroleum Intelligence Weekly, 20 February 1989, 4.

[166] Letter from Foreign Contractors Coordinating Agency to the Production-Sharing Contractors, 26 October 1988.

[167] Petroleum Intelligence Weekly, 29 May 1989, 7.

[168] Ibid.

[169] Petroleum Intelligence Weekly, 20 February 1989, 4.

contract areas.

In 1985 Pertamina's technical experts, those nationalists of a "guerilla breed", had to forsake their dream to explore the areas that they had previously reserved for themselves. They lacked the capital. Pertamina was forced to establish partnerships with foreign companies to expand production in these areas. Some companies were granted complete control over areas that in normal times, "would have remained the exclusive preserve of Pertamina."[170]

While Pertamina's retained some autonomy, its image as a symbol of nationalism was altered. Since the need to discover and develop additional oil was paramount, Pertamina's ability to set and pursue its entrepreneurial goals was circumscribed. Pertamina's accumulation goals had to be sacrificed at the altar of private accumulation by the transnationals.

But the state had provided selective incentives in conformance with the economics of the project. The government achieved its main objective: it would obtained guaranteed revenues before the oil companies recovered costs.[171] The nationalist agenda would remain a priority. The Ministry and the BKKA would remain integrally involved in procurement decisions and in maximising local content.[172]

Indonesia was not alone. Other governments also eroded their profit\production share as they reduced taxes and royalty rates and equity\or production splits in the changing international market conditions of the oil industry. In 1989 Algeria reduced the corporate tax to 65 percent and the royalty rate to 12.5 percent compared to the norm of 85 percent and 20 percent that OPEC had established in November 1974.[173] After reintroducing concession agreements under Oil Law No. 86. of 19 August 1986 which required at least 51 percent state participation, the Algerian National People's Assembly proposed amendments "designed to limit the minimum interest held by Sonatrach in association with foreign oil companies to 35%."[174] Libya went further. In one contract, for the first few years of commercial production, it eliminated taxes and royalties altogether.[175] Some countries returned to the fifty/fifty profit or production split.[176] Both Nigeria and Abu Dhabi increased the companies profit margins in 1986.[177] As it became clear that the transnationals would continue to play a significant role in their oil industries, these governments no longer held on to the principle of state ownership of the natural resource, that principle over which so many bitter battles had been fought in the preceding decades.

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[170] U.S. Embassy, Indonesia's Petroleum Sector (Jakarta: U.S. Embassy, 1988), 83.

[171] Letter received from government lawyer, 8 November 1989.

[172] Ibid.

Conclusion

In this chapter I have argued that changing international conditions in the oil industry forced the Indonesian state to make concessions to the transnationals. Although the Indonesian state remained dependent on the transnationals, it did not respond to the transnationals' demands from a position of absolute weakness. Like the transnationals, the Indonesian state brought several bargaining resources to the bargaining table. In the era of the benign bargain, governments and transnationals began to reassess their relationships on a more cooperative and less confrontational basis.

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[173] Petroleum and Taxation Report (New York: Gordon Barrows), July-August 1989, 3.

[174] Ibid.

[175] Petroleum and Taxation Report (New York: Gordon Barrows), May-June 1989, 3

[176] Petroleum and Taxation Report: Review of 1989 (New York: Gordon Barrows, 1990), 67.

[177] Petroleum Economist, September 1985, 339; Petroleum Economist, March 1986, 105.

In this era, the Indonesian government gave selective privileges to the transnationals based on performance standards. The Indonesian government did not abandon the nationalist agenda. It was forced to curtail and postpone it to suit changing market conditions. But since the Indonesian state is and will remain a dependent state with gradually increasing levels of autonomy, it can never ignore the demands of transnational corporate capital.

Chapter 9

Denationalisation?

This chapter demonstrates that the changing character of the international oil industry forced the Indonesian state to abridge its project to promote rapid Indonesianisation. In the first part of the chapter, I discuss the structure of the industry which is high-tech and geographically mobile. This gives it the shared characteristics of other manufacturing industries where it is more difficult for the state and local capital to enhance their bargaining power with respect to transnationals. The added difficulty with the oil supply and service industry is that its consumers are powerful transnationals with considerable consumer sovereignty. In this industry, as has been demonstrated in a number of bargaining "balance of power"/dynamic dependency studies, local firms tend to form alliances with transnationals so that it becomes more difficult for the state to make policy to regulate them. Finally, while denationalisation is partial in the Indonesian oil supply and service sector, rationalisation and integration between the larger local firms and foreign firms in equity and non-equity forms is highly visible.

Section I

The oil supply industry performs auxiliary functions for oil exploration, development and production. The phases of work usually covered by drilling job contracts range from the transportation of drilling equipment to the location of drilling and the installation of the well-head assy, but not including site clearing and laying the foundations for rig installations. The industry possesses the characteristics of high-tech manufacturing industries in which transnationals tend to produce very few inputs in the host country. Some of the most renowned of these international firms are Halliburton, Dresser Industries, Santa Fe, Zapata International, Weatherford and Baker International. These firms share the characteristics of high-tech transnationals whose manufacturing base is concentrated in the home country and for whom the host economy serves as an assembly or marketing base. The bargaining power of such firms is greater when their proprietary knowledge is critical to the success of the industry, the technology is changeable, and the industry is relatively footloose.[1] The garment industry displays similar characteristics, as I will show in Chapter 9.

In the high-technology service and supply sector, it is more difficult for local entrepreneurs to displace foreign companies completely if they wish to remain internationally competitive. This is particularly true when the state is financially unable to subsidise the inefficiencies that new entrepreneurs create when they are learning. As the ensuing discussion will show, the argument that manufacturing firms cannot be held hostage easily is particularly applicable to the oil supply sector which is geographically mobile.[2]

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[1] See for instance Grosse's discussion of transnationals in the computer and pharmaceutical industries. Robert Grosse, Multinationals in Latin America (London: Routledge, 1989), 79-80; The banking industry is a good example of a foot-loose industry where banks tend to shift deposits, loans, and workers to more desirable locations when there are changes in national laws. idem, 81-2. See Gereffi's discussion of the Mexican government's inability to force the steroid hormone producing drug companies to increase Mexican ownership or to increase Mexican exports Gary Gereffi, "The Renegotiation of Dependency and the Limits of State Autonomy in Mexico (1975-1982)," in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. Theodore H. Moran, Lexington, Mass.: Lexington Books, D.C. Heath, 1985), 83-106. See Kobrin's statistical conclusion that the bargain is unlikely to obsolesce in high-tech and dynamic manufacturing industries, a conclusion that corroborates Moran's views on this subject. Stephen J. Kobrin, "Testing the Bargaining Hypothesis in the Manufacturing Sector in Developing Countries," International Organization, 41, no.4 (Autumn 1987), 609-638. Moran argues that it is not high or low technology but technology's mutating nature that enhances the transnationals' bargaining power. T.H. Moran, "Multinational Corporations and Third World Investment," in Latin American: Dependency or Interdependence ed. Michael Novak and Michael P. Jackson (Washington DC: American Enterprise Institute for Public Policy Research, 1985), 17.

Bergsten, Horst, Moran argue that in industries where technology is complicated and alters quickly, it is difficult for host states and local firms to achieve a dramatic increase in their bargaining power. This is because the host government, local firms and state enterprises may be unable to sustain the momentum and expenditures for high levels of research and development.[3] Many host states and local firms share this feature in several manufacturing industries.

If the assumptions of the product-cycle model are taken to their logical conclusion, once a product has become standardised, the firm will not be able to maximise oligopolistic rents.[4] Innovation is essential for the firm to continue to obtain oligopolistic rents. As Strange argues, rapid innovation in an industry does not encourage rapid obsolescence of the original bargain between transnationals and host states and/or local firms. Indeed, she argues that recent changes in the global environment militate against such trends.[5]

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[2] Paul Hallwood, "Transnational Corporations and Industrial Diversification: The Case of the Offshore Oil-Supply Industry," Transnational Corporations 2 (February 1993), 92-4.

[3] Fred C. Bergsten, Thomas Horst, and Theodore H. Moran, American Multinationals and American Interests (Washington D.C.: Brookings Institution, 1978).

[4] Vernon developed the "product-cycle" model, a model of international technological diffusion in 1966. In 1979 he joined others in questioning its utility in a changing global environment. For the original formulation, see Raymond Vernon, "International Investment and International Trade in the Product Cycle," Quarterly Journal of Economics 80 (May 1966), 190-207. For Vernon's later discussion, see idem, "The Product Cycle Hypothesis in the New International Environment," Oxford Bulletin of Economics and Statistics 41 (November 1979), 255-67.

In such industries it is more difficult for the host government and/or local entrepreneurs to increase their bargaining power. It is often difficult for host governments to regulate the industry and for local firms to replicate the transnational corporations' firm-specific advantages from which they derive their competitive advantages over local firms. But even in these industries it is possible for local firms to displace transnationals. Brazil, India, and Korea have provided contrary evidence in their relationships with both U.S. and Japanese transnationals.[6] This evidence was first elaborated by Greico in the case of the Indian computer industry.[7]

In 1986, in his discussion of the Brazilian computer industry, Evans retracted his earlier formulation that transnationals would dominate industries where transnationals derived their competitive advantages from intangible capital such as proprietary knowledge and marketing expertise in oligopolistic industries.[8] He argued that while dependency continues, domestic firms could surmount the barriers to entry in high-technology industries although they may not be at the leading edge of technology.[9]

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[5] Susan Strange, "Big Business and the State," Millennium Journal of International Studies 20 (Summer 1991), 248.

[6] Dennis J. Encarnation, Dislodging Multinationals: India's Strategy in Comparative Perspective (Ithaca and London: Cornell University Press, 1989), chap.1; Peter B. Evans, "State, Capital, and the Transformation of Dependence: The Brazilian Computer Case," World Development 14 (1986), 791-808. Idem, "Declining Hegemony and Assertive Industrialization: U.S.-Brazilian Conflicts in the Computer Industry," International Organization 43 (Spring 1989), 207-238.

[7] Joseph M. Grieco, "Between Dependency and Autonomy: India's Experience with the International Computer Industry," in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. Theodore H. Moran, (Lexington, Mass.: Lexington Books, D.C. Heath, 1985), 55-82.

Transnationals are the principal generators of new technology through research and development and they play a major role in the international transfer of technology. In general, the parent companies of service companies do not invest significant amounts of capital in research and development although the oil service and supply sector is one of the three service industries in which research and development is comparable to other manufacturing industries.[10] Service transnationals generally tend to transfer very little hard technology and generate very little in their foreign affiliates.[11]

Thus, here too, it is necessary to analyse the relationship between transnationals and local firms in terms of the bilateral monopoly model and bargaining advantages that enable the transnationals to extract a higher supply price for technology transfers or for local firms and host governments to be able to reduce that price.[12] But not all local firms and public enterprises have to pay an equally high price to the transnationals. The factors that play a critical role in enabling local firms to surmount these barriers are the extent of local capital formation and the extent to which nationals have accumulated sufficient technical expertise.[13]

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[8] For his earlier formulation see Peter B. Evans, Dependent Development: The Alliance of Multinational, State, and Local Capital in Brazil (Princeton, N.J.: Princeton University Press, 1979). For his later formulation see Evans, "The Brazilian Computer Case," 791.

[9] Evans, "The Brazilian Computer Case," 803-5.

[10] UNCTC, Transnationals Corporations in World Development: Trends and Prospects (New York: United Nations, 1988), 450.

[11] Ibid.

[12] Farok J. Contractor, International Technology: Licensing, Compensation, Costs and Negotiations (Lexington: Lexington Books, 1981), 4.

In the oil supply industry local firms face several barriers to entry. The major oil supply transnationals possess certain firm-specific advantages that local firms cannot match.[14] First, transnational oil supply firms tend to locate non-manufacturing affiliates near the oil production site whereas their production sites for manufacturing oilfield equipment and machinery are usually located at home. This enables them to retain control over their technology and to take advantage of economies of scale. Consequently, there is less room for technology transfer in this sector. Second, through continued expenditures on research and development over the decades, these firms have accumulated a rich knowledge base which is protected through patents and trade-marks. The industry is subject to rapid technological change. These firms also possess specialised capital equipment and workers and they adopt sophisticated management techniques. Like other firms in high-technology industries, a new entrant would have to match all these features and also surmount rapid technological changes to remain internationally competitive.[15]

The transnational oil supply and service firms tend to protect their technology closely and are reluctant to license it to local firms - for fear of blemishing their international standing and to keep newcomers out, as Hymer had predicted in his theory of "oligopolistic advantage".[16] Since technology is an important source of market power for transnationals, parent companies tend to control research and development activities tightly to prevent information leakages to their competitors. They centralise their control over research and development at home since it is more difficult to control geographically dispersed facilities.

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[13] UNCTC, World Investment Report 1991: The Triad in Foreign Direct Investment (New York: United Nations, 1991), 71.

[14] Hallwood, "Industrial Diversification," 92-4.

[15] Ibid.

The geographical mobility of the industry encourages firms to establish non-manufacturing affiliates near the oil production site which conduct marketing, stock-holding, managerial, and servicing functions. Once a firm has completed its work, it leaves few traces of its former contribution to the local economy unless an indigenous joint-venture partner has developed the expertise to replicate its functions. Finally, the long-term health of the industry depends on the existence of substantial domestic reserves unless local firms can break into the export market. The oil supply industry is also characterised by relative capital intensity. The 1983 dollar value of the monthly operating and drilling costs for a drilling firm in Indonesia equalled $115, 000 and U.S.$404, 300 respectively.[17]

Section II

Has de-nationalisation in the high-technology and capital-intensive oil supply and service industry in Indonesia occurred as the dynamic dependency scholars have emphasised?[18] Is it more difficult for local firms to replace foreign corporations in the relatively high-technology industries?

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[16] Stephen Hymer, The International Operations of National Firms: A Study of Direct Foreign Investment (Cambridge, Mass: MIT Press, 1976).

[17] "The Oil and Gas Drilling Industry," Indonesian Commercial Newsletter, March 7 1983, 3-14.

Whether the state will bargain with the transnationals and impose restrictive policies on them depends on the state's objectives and its capacities at a particular historical juncture. In the late 1960s and in the beginning of the 1970s, the Indonesian state was willing to pay a higher supply price to the oil transnationals because its main objective was to promote oil exploration and development.[19] There was a recognition that Indonesian local entrepreneurs did not have the capital or the technical expertise to replicate the high-tech and high-risk functions performed by oil supply and service firms.[20] This pattern was similar to the general manufacturing sector and also applies to the garment industry in Indonesia and elsewhere.

In the late 1960s, in the absence of an entrepreneurial class to provide these services, the state adopted a non-interventionist role. The foreign oil companies were free to use the services of any company they chose.[21] But beginning in the 1970s, the state began to implement legislation to match the establishment of a state-owned company with the mandate to create the necessary infrastructure for the oil companies. In the early

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[18] Richard S. Newfarmer, Transnational Conglomerates and the Economics of Dependent Development: A Case Study of the International Electrical Oligopoly and Brazil's Electrical Industry Contemporary Studies in Economic and Financial Analysis, Vol. 23. (Greenwich, Conn.: Jai Press, 1977) 139. Also see Douglas Bennette and Kenneth Sharpe, Transnational Corporations Versus the State: The Political Economy of the Mexican Auto Industry (Princeton: Princeton University Press, 1985).

[19] High-ranking government official, interview by author, Jakarta, 15 January 1987.

[20] Ibid.; High-ranking government official, interview by author, Jakarta, 27 May 1987.

[21] Interview Ir. Wijarso, Special Advisor to the Minister of Mines and Energy, interview by author, Jakarta, 27 May 1987.

1970s the state began to bargain with transnationals to increase its role in the regulatory and the accumulation process. In early 1972 the state introduced legislation to restrict the entry of foreign service firms which were expected to establish joint ventures with domestic firms or Pertamina, maximise the utilisation of local goods and services and employ Indonesian personnel.[22] Only those companies registered with MIGAS could operate as sub-contractors.[23]

All foreign companies and sub-contractors were expected to obtain licenses by 1 July 1972 if they wished to participate in the Indonesian oil industry.[24] Through the 1970s, new sub-sectors were gradually closed to foreign firms. Commodities supply and catering were closed to foreign investors in 1974, manufacturing and steel pipes and girders for use in exploration and production in 1975, light construction and drilling and manufacturing followed in 1976, materials and equipment supply and offshore marine services in 1978. Examples of Pertamina's joint ventures partners were P.T. Dresser Macobar, P.T. Brown and Root Indonesia, P.T. Patra Vickers, and P.T. Chicago Bridge and Iron.[25]

Restrictiveness had two sources. First, it stemmed from the state's desire to include Pertamina and local capital into the nationalist accumulation programme. Second, it derived from the transnationals desire to establish a defensive oligopoly.[26]

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[22] U.S. Embassy, Indonesia's Petroleum Sector (Jakarta: U.S. Embassy, 1972), 10.

[23] Interview Ir. Wijarso, Special Advisor to the Minister of Mines and Energy, interview by author, Jakarta, 27 May 1987.

[24] U.S. Embassy, Indonesia's Petroleum Sector (Jakarta: U.S. Embassy, 1972), 10-11.

[25] Jean Aden, "Entrepreneurship and Protection in the Indonesian Oil Service Industry," in Southeast Asian Capitalists ed. Ruth McVey (New York: Cornell University Press, 1992), 93.

The most active foreign companies involved in drilling activities in Indonesia were Brikerhoff International, Parker Drill, Westburne, Zapata, Reading and Bates and Atwood. These were the first firms to enter the Indonesian market. They bunched together in the classic manner that Knickerbocker has demonstrated in his "follow-the-leader" thesis.[27]

The first foreign firms that entered the Indonesian market sought government protection so that in alliance with Pertamina and local firms they could establish a defensive oligopoly to ward off their competitors. Transnationals are natural oligopolists. They are not, as classical economists insist, free enterprisers. They seek the state's aid to protect them from competition. Protection through non-tariff barriers enables the transnational firm to maximise its profits because it has few competitors.

In Indonesia, an alliance was formed among foreign capital, the state, and local capital to reduce competition. Through joint ventures the state becomes a direct partner of foreign capital in the joint project of capital accumulation. The joint venture fortifies the bond between the state and transnationals and gives public enterprises the occasion to take part in those projects which they would be unable to undertake alone.[28] These alliances enable the state to move beyond the mere provision of infrastructural goods and services into the realm of production without replacing the transnationals. "Joint ventures tend to take place in sectors that lie on the buffer zones" between the territories of different kinds of capital. Alliances blur the boundaries. Joint ventures are a way of drawing transnationals into a nationalist schema of accumulation."[29]

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[26] Giddy and Young identified a variety of strategies that firms use to capture market share - offensive, defensive, initiative, opportunist among others. Ian H. Giddy and Stephen Young, "Conventional Theory and Unconventional Multinationals: Do New Forms of Multinational Enterprise Require New Theories?" in New Theories of the Multinational Enterprise ed. Alan M. Rugman (London and Canberra: Croom Helm, 1982), 66-70.

[27] For the "burst" phenomenon in manufacturing see Frederick T. Knickerbocker, Oligopolistic Reaction and Multinational Enterprise (Boston: Harvard University School of Business Administration, 1973), chap. 7.

They also draw a select few, privileged would-be local entrepreneurs into the "nationalist schema of accumulation." Sutowo personally benefitted from the restrictive practices that aimed to create a protected market. He established several firms for himself and his son Ponjo under the aegis of the Nugra Santana group. And by making capital and contracts available to other local entrepreneurs, Sutowo personally promoted the rise of an entrepreneurial class with strong connections to the military bureaucracy. Sutowo advocated a principle that he was fond of repeating, "learning by doing."[30] In his view if the state incurred high costs by providing protection to inexperienced entrepreneurs and if their services were not as efficient or of as high a calibre as those that could be obtained from foreign firms, then this was the price that had to be paid since domestic capital accumulation could only be achieved through experience.[31]

But in the oil industry the defensive oligopoly was never complete. This was because the large integrated international firms continued to use the services of their own affiliates. This limited the market share of the joint ventures in the oil supply and service sector.

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[28] Evans, Dependent Development, 227.

[29] Ibid.

[30] Ibnu Sutowo, former President-Director, Pertamina, interview by author, Jakarta, 15 January 1987.

[31] Ibid.

The nucleus of an indigenous service industry had emerged by the mid-1980s. One-third of the drilling companies were wholly-owned firms or joint ventures with majority Indonesian share-holding. Even in this high-tech industry there were domestic firms that had the capital to establish themselves as viable companies. In 1986 out of a total of 75 companies there were 24 PMDN companies. They were connected to larger domestic conglomerates, they had some linkages with foreign firms, and had established their credibility over the years.[32] "Increased professionalism among oil service entrepreneurs and a growing appreciation of it within the government has set the stage for Indonesian-owned and managed oil service companies."[33]

But the local industry's market share was small and it faced difficulty in overcoming the barriers to entry erected by the upstream oil producing transnationals and the majority-owned joint ventures controlled by the foreign supply and service companies. Foreign firms were still placing their work overseas. Capable Indonesian firms had to take on smaller jobs to prove and establish their credibility. Many companies and even Pertamina had greater faith in foreign firms and expatriates. In addition, the upstream oil-producing transnationals were unwilling to sub-contract jobs to local firms. They were also unwilling to disclose their annual exploration programs which made it difficult for drilling companies to make corporate plans.[34]

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[32] High-ranking government official, interview by author, Jakarta, 27 May 1987.
[33] Aden, "Entrepreneurship and Protection," 101.
[34] The Jakarta Post, 21 November 1987.

In 1985, 47 of the Indonesian Drilling Association's (AMPI) 72 members did not have contracts.[35] In 1986, Rudijono Hadi, Deputy Chairman of AMPI announced that 40 of its members had ended their operations because of declining drilling demand.[36] Some sectors such as pipeline construction, shrank 90 percent between 1982 and 1987.[37] The industry was being rationalised. With reduced protection and increased world-wide competition among oil service companies, it became more difficult for the uncompetitive and smaller national service and supply company to survive. In November 1987, H.E. Kowara, the Chairman of AMPI emphasised that unhealthy competition would destroy the industry.[38] In 1988 Arco's President, T.N. Macmud, reiterated this concern.[39] In 1985, Susilo Mertohadikusomo, deputy chairman of AMPI, had lamented the fate of many Indonesian constractors who would go bankrupt.[40] With rationalisation, the industry naturally became more biased towards the larger domestic and foreign firms.

In the main, Mobil, Asamera, Caltex used their own affiliated companies to conduct, their drilling operations.[41] Even Pertamina tended to utilise the services of its own affiliates although it gave priority to domestic over foreign firms. Petromar Trend and Arco were sub-contracting work to Westburne International, Santa Fe, and Dual Drilling Company - all U.S.-based oil supply firms which operated in Indonesia with 80 percent equity while their domestic partners retained a 20 percent share.[42]

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[35] See comments of Susilo Mertohadikusumu, AMPI's Deputy Chairperson, that out of 72 contractors in the AMPI membership did not have contracts. "Oil Drilling Contractors Face Depressed Market," The Jakarta Post, 31 August 1985.

[36] The Jakarta Post, 6 May 1986. In 1987 out of 34 onshore and 11 offshore drilling rigs only 55 percent were used. The remaining 45 percent were idle. 50 percent of the registered oil drilling companies had not obtained jobs for one to three years. "Contracts Drying Up for Oil Drilling Firms," The Jakarta Post, 21 November 1987.

[37] U.S. Embassy, Indonesia: The Petroleum Report (Jakarta: U.S. Embassy, 1988), 94.

[38] The Indonesian Observor, 23 November 1987.

[39] Speech by Mr. T.N. Machmud, Arco President and Chief Executive Officer, The Jakarta Post, 25 October 1988.

[40] "Oil Drilling Contractors," The Jakarta Post, 31 August 1985.

[41] The Indonesian Observor, 23 November 1987.

Normally, the number of total rigs operating at any given time in Indonesia hovered around 100.[43] In 1986, the upstream oil-producing transnationals controlled 46 percent of Indonesia's rig activity, the transnational oil supply companies controlled another 33 percent in majority-owned joint-ventures, and wholly-owned domestic firms controlled 21 percent.[44] In 1982, out of 40 domestic drilling companies only five had succeeded in becoming internationally competitive and landing contracts from the oil companies. These were P.T. Pirmarda Esa, P.T. Medco, P.T. Patra Drilling, and P.T. Morina Jaya.[45] In October 1982 only three national drilling companies were operating drilling contracts - P.T. Gurdi, P.T. Utama, and P.T. Nusantara.[46] Consequently, domestic firms had to rely on the independent companies, an occasional contract from an oil major, and Pertamina to land a contract. But Pertamina, which produced only 5 percent of Indonesia's total oil, was limited in its ability to sub-contract drilling work to local firms.[47]

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[42] Migas, unpublished document, 1986; Santa Fe is now owned by Kuwait Petroleum National Company.

[43] Aden, "Entrepreneurship and Protection," 99.

[44] High-ranking government official, interview by author, Jakarta, 27 May 1987.

[45] Migas, unpublished document, 1986.

[46] "The Oil and Gas Drilling Industry," Indonesian Commercial Newsletter, 8.

[47] Ibid., 7.

State firms enter the market as competitors to local firms. The state's ability to act in a unified way is constrained by the fact that various contradictory interests emerge within the state apparatus. There can be conflict between the subsidiaries and affiliates of the state enterprise and their parent. The managers of state enterprises develop interests of their own which conflict with the general policy goals professed by the state. This is especially a problem when the affiliates are joint ventures with foreign companies. With its foreign partners or its wholly-owned subsidiaries, Pertamina continued to occupy the very space that it wanted local firms to inhabit.[48]

On the one hand, the BKKA promoted the maximum use of local content and of the services of local companies and it promised to vacate the oil supply sector. But in the mid-1980s, it had made little progress on that front. In the seismic and data processing service sector, which had become saturated with only seven firms, Pertamina's wholly-owned subsidiary, P.T. Elnusa dominated 40 percent of the market.[49] Pertamina tended to steer as much work to its subsidiary as possible to the competitive disadvantage of private firms. Similarly, in the air-taxi service, Pertamina had encouraged local firms to indigenise rapidly and although P.T. Pelita had originally claimed a monopoly over the air-taxi service and it had allowed this monopoly to be eroded by domestic firms, Sumbono had tended to favour Pelita over other foreign/domestic joint ventures as the state-oil company began to be attacked for its lack of profitability. In 1985, Pelita controlled 70 percent of the market.[50]

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[48] Petromin, May 1984, 16.

[49] "Budget Squeeze Hits Processors," Petroleum News: Asia's Energy Journal, May 1986, 15.

The local industry relied completely on imported inputs. Although Indonesian oil had been produced and exported for a century by 1985, Indonesian industry produced no drill bits or tubulars. In contrast, Japan and Singapore produced no oil. But Japan produced tubulars and Singapore produced drill bits. Consequently, local content was being promoted primarily with imported components sold by Indonesian companies that were in the main agents of foreign service and supply companies.[51]

Bennette and Sharpe have argued that the state's bargaining power is determined by a great deal more than its relative capabilities. Domestic and international constraints intervene between potential power and its actualisation. The Indonesian state may have wished to expand the role of local service companies but it was limited by domestic and international constraints. The fate of local service companies was in the hands of the upstream international firms, the consumers of their services. Unlike ordinary consumers, who enjoy little consumer sovereignty, the transnational oil companies were consumers with power: they could prevent the growth and development of local service firms. They could not be forced to consume a service or product that did not match the high standards at the leading edge of technology.

> Host states need to understand the overall strategy of global MNEs and how their affiliates fit into this strategy. While the host state and domestic interest groups may see foreign firms as levers of change and adopt strategies that target particular MNE policies, affiliates vary in their will

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[50] "A Losing Battle: Indonesianisation Takes its Toll on Air Support," Petroleum News: Asia's Energy Journal, May 1986, 61-64.

[51] High-ranking government engineer, interview by author, Jakarta, 25 March 1987.

and capacity to respond.[52]

The survival of the domestic firm depended on the willingness of the oil producing transnationals to expend exploration and development budgets in Indonesia and their willingness to sub-contract work to local firms. The structural power of the transnationals limited the bargaining power of the state. The state could not force the transnational oil company to subsidise the growth of a domestic entrepreneurial class. And as I have shown earlier, with the oil glut and unfavourable investment conditions they had reduced their exploration activities. In the oil service sector, the oil producing transnationals would contest the state's developmental goals. Their control over the Indonesian upstream sector ensured that their hold over the oil supply and service sector could not be demolished easily, especially since it rested on technology and marketing expertise.[53]

The large international firm could not be prevented from utilising the services of its affiliated companies.[54] Technology is one area where the large integrated firm has been able to maintain its leverage with respect to the host government. Transnationals tend to utilise their internal markets to reduce their transaction costs and maximise their global profits.[55] They utilise their own patented technologies and their own affiliated service companies. Through transfer pricing they can book any price for the services that they obtain from their affiliates. To use domestically supplied components and services would put their own service companies, their personnel, and their patented technologies out of business.

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[52] Lorraine Eden, "Bringing the Firm Back In: Multinationals in IPE," Millennium Journal of International Studies 20 (Summer 1991), 216.

[53] See for instance, Gereffi's discussion in Gary Gereffi, The Pharmaceutical Industry, 159.

[54] Chairman, Managing Board, major oil company, interview by author, Jakarta, 5 January 1987.

[55] For an excellent discussion see James C. W. Ahiakpor, Multinationals and Economic Development: An Integration of Competing Theories (London and New York: Routledge, 1990), chap.2.

Transnationals use transfer prices for a variety of often contradictory reasons. For instance, there is a conflict between charging low international prices to help established subsidiaries to compete or survive in a country by showing higher artificially higher profits and then using these profits for the performance evaluation of foreign subsidiary managers.[56] Again, transnationals often charge their subsidiaries higher transfer prices to evade host government taxation and foreign exchange controls.

This is where there is a divergence between the host state's interests and the interests of the transnational. Host governments are interested in the profits realised by a transnational, and transfer prices make a big difference in the amounts of income taxes paid to the government.[57] A transnational can charge high international transfer prices for imported goods to report lower profits for its foreign subsidiaries to avoid host government interference when they show higher profitability.[58]

In various case studies several scholars have found that it is more difficult for the state to increase its bargaining power in the manufacturing sector because transnationals tend to forge alliances with local suppliers, distributors, and creditors. These scholars argue that the state cannot take a tough stand with respect to transnationals because domestic and foreign firms bring their concerted pressure to bear on the government to reverse its regulatory decisions. Moran argues that the joint venture with private capital solidifies the position of the transnationals with respect to the state and prevents it from enacting radical moves against the foreign firm.[59] Lall comments that a major development that has defused conflict between transnationals and local firms has been the growth of joint ventures between the two.[60]

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[56] Wagdy M. Abdallah, International Transfer Pricing Policies: Decision-Making Guidelines for Multinational Corporations (New York: Quorum Books, 1989), 22.

[57] Ibid.

[58] Ibid.

This phenomenon became evident in Indonesia's oil supply and service sector in the 1980s. The kinds of alliances that are forged are patterned by the interests of the actors involved in the conflict. These interests are in turn determined by the manner in which the national and international political economy and the national and international structures of the industry shape the relationships among the actors.[61]

The Indonesian local firms were willing recipients of a dependency relationship with the foreign service companies and they did not see themselves in conflict with the foreign oil service companies.[62] Domestic and foreign firms formed an alliance to denounce the government's hastened Indonesianisation program. The oil producing transnationals set their agenda in such a way as to focus on the contradictions in state policy without attacking their local allies.[63] The transnationals did not oppose indigenisation. It was politically unacceptable for them to attack the strongly and widely held belief that transnationals and foreign workers were a mere supplement to national personnel and domestic firms until they had achieved the capacity to completely displace their foreign counterparts. This line had been official New Order policy. And it is common policy in industrialising states.

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[59] Stephen J. Kobrin, "The Forced Divestment of Foreign Enterprise in the LDCs," International Organization 34 (Winter 1980), 65-88. Also see idem "Diffusion as an Explanation of Oil Nationalization: Or the Domino Effect Rides Again," Journal of Conflict Resolution 29 (March 1985), 3-32.

[60] Sanjaya Lall, Multinationals, Technology, and Exports: Selected Papers (New York: St. Martin's Press, 1985), 80.

[61] For an excellent discussion of alliances in their various forms, see Evans, Dependent Development. For the ingredients of alliance formation, see Bennette and Sharpe, Mexican Auto Industry, 90-1; Moran, Politics of Dependence, 190-197.

[62] Nick Longworth, "AMPI Sets Standards for Management Training," Petromin, July 1985, 16.

The transnationals made a case against bureaucratic red tape, the manner and speed with which the indigenisation program was being implemented, and the state's conflicting goals - its desire to promote a local entrepreneurial class which would raise production costs and its desire to cut production costs to enhance state revenues. They argued that increased costs through bureaucratic delays undermined the state's goals of cutting production costs. Later they argued that the state's desire to enhance production would be undermined by its promotion of an entrepreneurial class.

The oil producing companies argued that they were reluctant to utilise the services of domestic firms because they were inefficient. As a matter of form they began to add 20 percent to their original operating costs as a rationale to cover the inefficiencies caused by the use of domestic firms and bureaucratic delays.[64] Many of them inflated their costs even when they used the services of local firms to the minimum.[65]

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[63] For the manner in which transnationals seek to set the political agenda in their interests, see Bennette and Sharpe, Transnational Corporations. Idem, "Agenda Setting and Bargaining Power: The Mexican State Versus Transnational Automobile Corporations," World Politics 32 (October 1979), 57-89. Gary Gereffi, The Pharmaceutical Industry.

[64] Corporate executive, major oil company, interview by author, Jakarta, 18 April 1987.

A common practice adopted by transnationals in developing countries to overcome the shareholding requirements imposed by host states is to appoint front or dummy partners.[66] This is one of the risk-reducing techniques that corporations use to defend themselves from daily economic nationalism that Moran has described[67] and that I have alluded to earlier. This practice was adopted with alacrity by the oil-producing firms in Indonesia. From 1980 to 1984, companies sought to undermine the intent of Kepres 14A by using front companies who simply passed orders to foreign suppliers or performed limited tasks such as inventory control. The oil companies preferred to expend the overhead costs involved in maintaining a front company instead of sub-contracting work to an Indonesian company.[68]

Changing international and domestic structural conditions have an impact on the bargaining power of local firms and host governments. Corresponding with the oil price increases in the late 1970s the world-wide exploration services industry underwent a massive boom. But as soon as it became evident that there was a glut in the oil market, there was a reduction in exploration projects and the services industry faced massive over-capacity.

In Indonesia, parallel developments occurred. The surge in exploration contracts between Pertamina and foreign oil companies prompted many local companies to enter the drilling market. Pertamina had signed eleven, twelve, and thirteen production-sharing contracts in 1980, 1981, and 1982 respectively. In the expectation that there would be rising exploration activity, MIGAS had allowed a large number of domestic companies to enter the fray.

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[65] Ibid.

[66] Hallwood, "Industrial Diversification," 97.

[67] T.H. Moran, "International Political Risk Assessment, Corporate Planning, and Strategies to Offset Political Risk," in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. T.H. Moran (Lexington, Mass.: Lexington Books, D.C. Heath, 1985), 115.

[68] High-ranking government lawyer, interview by author, Jakarta, 11 February 1987.

But when the oil market began to slump, a huge over-capacity resulted which led to cut-throat competition among drilling firms.[69] Not all were chosen. Migas began to limit the issue of licenses to reduce competition and to encourage rationalisation. Even the transnational service companies were forced to reduce their activities because of declining demand. In 1986, Bambang Ibnu Hartono, the Indonesian Chief executive of P.T. Pacific Kellog, Schlumberger's domestic affiliate, announced that the company planned to reduce its activities because of declining demand.[70]

By the late 1980s much of the local industry was associated with foreign service companies. One strategy that domestic firms pursued to combat cut-throat competition was to strengthen their associations with foreign firms.[71] With their global networks and their world-wide operations, the transnationals were in a better position to spread their risks and losses. This made the foreign association even more critical for the domestic entrepreneur and it enhanced the bargaining power of the foreign transnationals with their domestic partners.[72]

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[69] Petromin, October 1985, 26.

[70] The Jakarta Post, 6 May 1986.

[71] Nick Longworth, "Indonesian Support and Service: Establishing an Indigenous Presence in the Marketplace Takes Time", Petromin, July 1985, 12-13, 16.

[72] High-ranking government engineer, interview by author, Jakarta, 25 March 1987.

As the pressures to remain internationally competitive increased, foreign partners became even more unwilling to transfer their shares to domestic entrepreneurs. There is general agreement in the literature that the extent to which a company internalises its activities depends on its competitive advantages. Thus only those firms that can retain their competitive advantages despite the loss of equity willingly transfer majority equity shares to local firms.

Transnationals seek to internalise their technological advantages, to use their own personnel, and to market their products in a manner that maximises their global profitability. Technology is a closely guarded secret which they are unwilling to share with local entrepreneurs and host governments. If they were to share their innovations, they would be unable to derive the oligopolistic rents that they derive from limiting accessibility to their technology and they would not be able to prevent the further erosion of their firm-specific advantages.

The integration between stronger local capital and the transnationals is further strengthened by collaboration in and concerted lobbying through institutionalised joint-industry associations. AMPI blamed the government for the domestic industry's plight. H.E. Kowara, AMPI's Chairman in 1987 and the owners of a large private construction company that supplied steel pipes to Pertamina, argued that in its enthusiastic and rushed desire to encourage a domestic entrepreneurial class and the utilisation of local content the state had encouraged high debt-to-equity ratios among domestic firms because of the criteria that were used to measure "national content". He argued that MIGAS's preferential treatment for companies that maximised their utilisation of Indonesian-owned capital, assets, management, and workers had led national companies to expedite the acquisition of rigs and their indebtedness. Rig-ownership had become a liability in the over-supplied market of the mid-1980s.[73]

The industry leadership argued that the government had encouraged too many companies

to enter the industry because it had raised their expectations. In a hearing before the parliamentary Committee VI, Kowara noted that the government had only issued 200 licenses in 1987 when its annual target for wells to be drilled was 900.[74] Kowara noted that in 1987, AMPI members had invested U.S. $420 million in their companies for which they had borrowed finances from domestic and foreign banks but 45 of them (50 percent) did not have contracts.[75] Indeed, some domestic firms were displeased by the BKPM's restrictiveness in limiting the number of foreign experts that they could hire since they saw foreign managerial and technical expertise as essential to their competitiveness.[76]

Domestic companies obtained several benefits from their joint affiliations with transnational corporations. Access to brand names enabled these firms to increase their credibility which in turn enabled them to capture market share. Thus the General Affairs manager of Bredoro Price's Indonesian subsidiary W.H. Muaya, insisted that it was in association with its foreign counterpart that enabled the company to convince sceptical oil companies of its pipe-coating abilities.[77]

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[73] The Indonesian Observor, 23 November 1987. See also statements of Susilo Mertohadikusumu, Deputy Chairperson of AMPI in "Oil Drilling Contractors," The Jakarta Post, 31 August 1985.

[74] Ibid.

[75] Ibid.

[76] "Drilling Industry," Indonesian Commercial Newsletter, 13.

Of course, the de-linking of equity ownership from other firm-specific advantages has been noted by Dunning in his "eclectic" theory of the firm.[78] Omar draws attention to the increasing popularity of non-equity forms of transnational activity in industrialising countries. Dunning argues that firms can often derive oligopolistic rents through control over marketing technology and financing without equity ownership. De-linking the transnationals' full package of firm-specific assets does not necessarily imply that the domestic investor and/or state have achieved greater control over the industry. But there is also the other pressure. De-linking has also become necessary as host governments and/or domestic entrepreneurs have became more knowledgeable. They have accumulated capital, are able to obtain expertise more easily on the open market, and are unwilling to accept a complete package of facilities from the transnational.

De-linking has one of two alternative sources. It is necessary to distinguish and determine the source of the de-linking process - whether it is the product of a transnational's willing abandonment of equity because it can continue to retain control over its competitive advantages or because it is the result of increased host country or domestic investor capacity. Both trends were evident in the Indonesian oil supply and service sector.[79]

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[77] Longworth, "Indigenous Presence," 12.

[78] See Farok Contractor and Peter Lorange, Cooperative Strategies in International Business (Lexington, Mass: Lexington Books, 1987). Charles Oman, New Forms of Investment in Developing Country Industries: Mining, Petrochemicals, Automobiles, Textiles, Food, Paris: Development Centre of the Organisation for Economic Cooperation and Development, 1989. Kindleberger has commented that these arrangements are not quite so new. Charles Kindleberger, "The 'New' Multinationalization of Business," ASEAN Economic Bulletin (November 1988), 113-24.

The Indonesian domestic firms did not seek to challenge the transnationals nor did they express confidence that they could replace foreign firms. What they sought was a greater share of the market and this they believed they could best achieve through alliances with foreign firms. They could access foreign technical expertise through joint ventures or in un-bundled form but the foreign linkage was considered essential to their survival and for them to grow and continually obtain access to new technology to remain competitive.[80] Domestic firms hired expatriates to improve their managerial and technical capacities which they believed was essential for them to achieve competitiveness.[81]

All domestic firms did not believe that it was necessary for them to continue the foreign linkage through a majority-owned joint venture. Some domestic firms with their own capital or loans from domestic/and or off-shore banks could unbundle the transnational firm's package of tangible and intangible assets. They could hire foreign experts, rent or buy drilling rigs, obtain licenses to utilise or sell the patented technology of foreign firms.[82] But for most of them, less than a decade had passed since they had become involved in the service sector. It was essential for newly established domestic firms to work in partnership with foreign firms. Domestic firms sought a gestation period before they acquired majority equity participation from their foreign counterparts. Local firms were convinced that a tenuous relationship with foreign drilling companies would prevent them from achieving the efficiency, safety-standards, and the high-tech services required by their customers, the international oil companies.[83] Even the larger domestic firms with adequate capital to run their operations alone sought the protective shield of their foreign counterparts to deal with the dynamic and high-risk character of the industry. The indigenisation process in the air-taxi service had not been rapid. With the exception of one wholly-owned firm and one firm with a 51 percent share, the remaining 10 firms only had 20-30 percent equity interests. But the local firms complained that they would not benefit from rapid indigenisation.[84]

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[79] For an excellent discussion of the impact of various arm's-length and internalised forms of technology transfer and the manner in which firms extract rents see Richard E.Caves, "Multinational Enterprises and Technology Transfer," in New Theories of the Multinational Enterprise ed. Alan Rugman (London and Canberra, Croom Helm, 1982), 254-279.

[80] Paul Handley, "Who Said It was Easy: It's a Hard Road to Indonesianization," Petroleum News, May 1985, 57-58.

[81] Longworth, "Indigenous Presence," 12.

According to Susilo Mertohadikusomo, deputy chairman of AMPI, joint-venture drilling companies had fared better than the newly established domestic firms: they had low debt-to-equity ratios because they had recovered all their rig-owning costs during the boom years.[85] The industry leadership itself emphasised that it would be difficult for domestic drilling firms to achieve the government's target of 51 percent ownership in the oil drilling sector.[86]

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[82] High-ranking government engineer, interview by author, Jakarta, 27 March 1987.
[83] Longworth, "Indigenous Presence."
[84] High-ranking government lawyer, interview by author, Jakarta, 6 May 1987.
[85] The Jakarta Post, 6 May 1985.

The non-equity and equity relationships between foreign firms and local firms institutionalised their shared control and brought a community of interests between them.[87] To justify a continued relationship with foreign firms, the foreign and domestic firms argued that technology was a dynamic, not a static phenomenon. The head of one local service company explained, "We keep on learning and it does not take long to absorb new technology but the source of new technology is foreign. So we have to have foreigners."[88] Domestic firms argued that as long as they did not conduct their own research and development and create their own technology, they had to depend on foreign firms. An owner of a national drilling company noted that foreign companies would continue to dominate drilling primarily because they had greater expertise, stronger financial resources, and to prevent the erosion of their control over their firm-specific advantages.[89]

Even when technology is diffused to host countries, foreign firms can maintain a strategic advantage over domestic firms because of innovation and the dynamic nature of technology. Consequently, in a dynamic sense dependence can be a continued state. What is the state to do when local firms themselves insist that they cannot do without their foreign partners in a "high-risk industry"?

In addition, the capitalist state is unable to bargain with transnationals from a position of strength when the supply price it is willing to pay endangers the long-term health of the industry. It then endangers its own existence. The state conceded to the pressure of domestic and foreign investors. The government explicitly aligned with the upstream transnational oil corporations.

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[86] see the comments of Siwono Yudohusodo, Kadin's Public Affairs Deputy Chairperson, Kompas, 1 May 1986.

[87] Longworth, "Indigenous Presence," 12.

[88] Ibid., 16.

[89] Ibid. Also see "Drilling Industry," Indonesia Commercial Newsletter, 12.

In the case of the supply industry, the state could sacrifice its legitimation function because the domestic entrepreneurial class itself did not see its interests threatened by the continued dominance of transnationals in the development project. The state was also not willing to endanger the continued accumulation of capital that the upstream transnational oil companies provided. They had explicitly refused to subsidise local firms whose fate depended directly on the upstream oil producing companies' expenditures. If the international firm reduced its expenditures as the 1983-1987 period had shown, then there would be reduced activity and reduced work for them. The Indonesian state itself was not willing to jeopardise its long-term absolute revenues by bargaining with the oil transnationals about the fate of local firms.

Changing structural conditions in the international market can also reduce the state's bargaining power and may require the state to re-define its strategies. The state had its own interests which went beyond safeguarding the general interests of capitalist accumulation. Cash-strapped as it was, the state could no longer afford to protect and underwrite the high costs of inefficient service and supply companies in the name of domestic capital accumulation and import-substitution industrialisation. Sutowo's legacy of "learning by doing" had to be checked. The conviction of economic nationalists such as Ginandjar Kartasasmita and Habibie that the Indonesian consumer and state could and must bear the additional costs of inefficient production to further Indonesianisation had to be dampened.

In mid-1986, the Director-General of Migas, Sudharno, acknowledged that the technological requirements of the industry made joint ventures with foreign companies essential to the survival of the local industry.[90] In 1987 R.O. Hutapea, the Technical Director of Oil and Natural Gas Mining in the Ministry of Mines and Energy, conceded that the government's goal for the gradual transfer of the construction business for offshore platforms to Indonesian firms had to be abandoned because they lacked the necessary technical know-how.[91]

Whereas previously domestic partnership and the divestment of foreign majority shareholding had been mandated, the government now merely encouraged foreign companies to divest their shares within 15 years.[92] The state did not enforce the 1979 regulation that foreign investors transfer their shares to their Indonesian partners within ten years. The state was forced to relax its "buy Indonesian, hire an Indonesian" program for the oil service and supply sector.

The BKPM began to remove restrictions on foreign investment in areas that had been previously reserved for domestic and incumbent foreign investors - seismic, geological, and related services, and manufacturing and assembling of field and plant equipment. In May 1986, as part of its de-regulation package, the government re-opened several sectors to foreign investment including underwater work and testing, offshore oil and gas drilling, design, engineering and consultancy for oil and gas production, floating production and processing, storage and off-loading facilities, manufacturing and assembling of field and plant equipment, and temporary production systems.[93]

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[90] Prioritas, 1 May 1986.

[91] Indonesian Observor, 5 September 1987; High-ranking government engineer, interview by author, Jakarta, 24 March 1987. In January 1987, the government approved three joint ventures - P.T. Schlumberger Production Services Nusantara, P.T. Schlumberger Geophysics Nusantara, and P.T. Udemco Otis Indonesia. The Jakarta Post, 30 January 1987.

[92] U.S. Embassy, The Petroleum Report: Indonesia (Jakarta: U.S. Embassy, 1988), 94.

But bargaining remains viable. As long as host countries have not achieved international competitiveness in research and development, they are forced to confine their regulatory role to ensuring that foreign firms diffuse technology in a manner that maximises the benefits to the host country. But as Gereffi argues "this will require that national sovereignty be flexed, not buried."[94] The state did not abandon its desire to promote local control and ownership in the industry. It did not abandon regulation and non-tariff barriers to protect domestic and incumbent foreign firms. Indeed, as a general policy measure Indonesia was one of the few countries to increase sectoral limitations, although like most other governments, it also stream-lined and simplified procedures.[95] The Indonesian state still expected domestic firms to attain majority share-holding within 15 years. Foreign service and materials suppliers were expected to sign joint ventures with local firms and to commit a minimum investment of U.S. $500,000.[96]

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[93] U.S. Embassy, The Petroleum Report: Indonesia (Jakarta: U.S. Embassy, 1986), 61.

[94] Gereffi, "Renegotiation of Dependency," 102.

[95] United Nations Centre on Transnational Corporations, Government Policies and Foreign Direct Investment (New York: United Nations, 1991), 13.

[96] U.S. Embassy, The Petroleum Report: Indonesia (Jakarta: U.S. Embassy, 1988), 94.

Nor did the state abandon protection for foreign joint ventures. Indeed, in his passionate quest to promote local content, Ginandjar Kartasasmita had become an enthusiastic champion of the interests of incumbent foreign investors as I will show in greater detail in my discussion of the textile industry. In 1986 Ginandjar Kartasasmita reaffirmed that only established foreign firms would be allowed to continue their operations in the drilling sector. By mid-1987, once enough foreign investors had entered the fray, the BKPM closed support services for drilling and gas exploration in off-shore areas and oil and gas under-water works to foreign investors.[97]

Reduced protection, a glut in the worldwide oil service sector, and the industry shakedown that followed the 1983 worldwide recession, had made it more difficult for the wholly-owned local supply and service company to survive. Reduced protection encouraged rationalisation which served the interests of the larger firms, foreign and domestic, since competition was driving them all to the wall. The fitter companies remained competitive but a large number of companies registered on the Migas list disappeared into oblivion. As Evans argues, the alliance among the state, transnationals, and local capital succeeds when the ties of the stronger fraction of the local capitalist class are severed from its weaker fraction; and when the bond between the larger and stronger local firms and transnationals is strengthened.[98]

How does Indonesia's oil supply and service industry fit into the global industry? Vernon's product-cycle model, combined with the arguments of dynamic dependency scholars such as Evans and world system theorists such as Wallerstein are useful to understand Indonesia's changing position in the hierarchical division of labour in the international oil supply and service sector.[99] According to world systems theory, the world is divided into central, peripheral, and semi-peripheral areas. There is a hierarchical division of labour in the world capitalist system, as Wallerstein would argue. But as Evans emphasises states can alter their position in the hierarchical world capitalist system.[100] As semi-peripheral countries gradually begin to join the central countries in discharging high-tech, capital-intensive tasks requiring greater skills, those countries that were once in a peripheral position are allowed to fill the existing void and to perform the functions that the semi-peripheral countries once executed.

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[97] The Jakarta Post, 26 May 1987.

[98] Evans, Dependent Development, 244-45.

But states cannot achieve this new role if they do not seize the occasion to change the existing hierarchical division of labour in their favour. Political will must be combined with opportunity. It is in these terms that the gradual development of Batam Island, a 415 sq miles island with rolling hills and natural inlets twenty kilometres from the Malacca Straits, as an oil supply base can be understood. Sutowo and Suharto had jointly envisaged this role for the island in the early 1970s. When the Indonesian state imposed restrictive practices with respect to the oil supply and service sector in the 1970s, in return for obtaining an assured and protected position in Indonesia's oil industry, companies such as Mcdormett, one of the largest U.S. oil supply companies, agreed to establish facilities and create their own infrastructure on Batam. Bechtel, one of the largest U.S. construction and engineering companies, had won the license to plan and develop it.

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[99] Raymond Vernon, Sovereignty at Bay: The Multinational Spread of U.S. Enterprises. (Harmondsworth: Penguin Books, 1973, Basic Books, 1971) 71-82; Immanuel Wallerstein, The Modern World System: Capitalist Agriculture and the Origins of the European World-Economy in the Sixteenth Century (New York: Academic Press, 1974).

[100] Evans, Dependent Development, 25-34.

In the 1970s international and domestic factors prevented the Indonesian state from pursuing the objective of developing Batam Island as a supply and manufacturing base for the oil industry. In the early 1970s Batam Island had to compete with Singapore's sophisticated Jurong base. In the early 1970s, Singapore's hierarchical position in the world division of labour was such that the Singapore government and Singapore's corporations were unwilling to relinquish their regional dominance to Indonesia in the oil supply and service sector. Further, in the main, the oil transnationals were unwilling to shift their supply facilities to Indonesia. As well, the state had not created the necessary infrastructure to make Batam an attractive base. The state had also not introduced a stringent regulatory environment to force the transnationals to shift their supply base to Indonesia. The Pertamina crisis in the mid-1970s had forced the state to postpone the development of Batam and in effect part of its program to pursue import-substitution industrialisation.

But since the late 1970s the state had changed its stance.[101] Under the direction of Research and Development Minister Habibie, the state began to create the infrastructure to make Batam a viable alternative to Jurong. The government adopted the classic carrot-and-stick strategy to persuade the transnational oil companies to shift their supply bases to Batam. In the mid-1980s reluctant production-sharing contractors began to gradually shift their operations to Batam. The impetus also came from Singapore's changing position in the international division of labour. With the cooperation of the Singapore government and Singapore's corporations which now began to obtain equity participation in Indonesia's oil supply industry at Batam, the government began to create the infrastructure under the earnest direction of Research and Development Minister Habibie.[102] The government insisted that the oil companies would not be allowed to deduct import taxes if they did not comply with the government's requirements.

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[101] For growing nationalism with regard to the establishment of supply bases for the oil industry in host countries see Petromin, November 1985, 32-36.

Conclusion

The structuralist argument that the state will sacrifice the short-term interests of capital to safeguard the long-term goals of capital accumulation, was valid in the case of the oil supply and service industry. The state was forced to abridge its project to promote a local entrepreneurial class in the long-term interests of capital accumulation. The state could no longer bear the costs of inefficiency; the industry had to be rationalised. The state could not force the international oil firms to bear the burdens of subsidising local firms, costs that it might have chosen to bear itself. But when oil prices came crashing down, the state itself was unable to bear the additional costs so that it had to concede to the transnationals' demands and allow them greater freedom to cut costs.

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[102] For a general survey of the changing investment role of the newly industrialising countries in Indonesia see The Kian Wie, "The Surge of NIC Investment into Indonesia," Bulletin of Indonesian Economic Studies 27 no.3 (December 1991), 60-61. For increasing Indonesian-Singapore trade see Lee Ju Song. "Singapore-Indonesia Trade 1988," Singapore International Chamber of Commerce: Economic Bulletin 18 (June 1989), 14-15, 17; Idem, "Singapore-Indonesia Trade 1990 - Special Report," Singapore International Chamber of Commerce: Economic Bulletin 20 (June 1991): 5-7. During the first half of 1990 Singapore's investment in Batam amounted to US$328 million accounting for 59 percent of batam's total investment making Singapore Batam's leading investor. Ibid., 7.

The demands of the upstream oil producing transnationals prevailed. Local firms had not achieved the capacity to replace the transnationals completely. They were therefore willing to pay a higher supply price to gain access to the transnationals' firm-specific advantages. As yet, local capitalists had not come to play such a powerful role in domestic politics as to force the state to pursue goals that served their interests exclusively. Indeed, they were unwilling to convince state agencies to pursue policies that would undermine their relationship with the foreign transnationals.

Chapter 10

Free for All: But for How Long?

This chapter traces the historical antecedents of the Indonesian textile industry to show that historical structures and the interaction of past external and internal conditions prevented the emergence of a textile industry in Indonesia until the late 1960s and early 1970s. The second section demonstrates how this conditioning caused the Indonesian state to adopt a weak bargaining stance towards transnationals from 1967 to 1974. This discussion transpires in the context of the motivations and structural characteristics that drove textile transnationals to enter the Indonesian industry. The third section reveals how beginning in 1974, entrenched and changing orientations within the state apparatus combined with populism produced a more restrictive state policy towards the textile transnationals.

Section I

In providing the historical background to the influx of foreign capital in the Indonesian economy during the late 1960s and early 1970s, I will argue that during the pre-1967 period the Indonesian textile industry was dominated by merchant capital. This factor prevented the development of industrial capital. The PKI Chairman D.N. Aidit was correct when in 1964 he observed that national capital had not made the transition from trade to industry.[1] The transition to industry took place when foreign firms entered the Indonesian economy in the late 1960s and early 1970s. Foreign capital subordinated merchant capital by launching an earnest programme of import-substitution industrialisation for the New Order regime.

In Chapter 2 I outlined Marx's distinction between merchant and industrial capitalism. Marx argued that in the modes of production pre-dating industrial capitalism, merchant capital performs the function of capital. Traders derive their profits from the difference between the purchase and selling price of circulating goods. They buy cheap and sell dear. The development of merchant capital is inversely proportional to the degree to which industrial capital has developed. If merchant capital is more highly developed, the possibility of stunted industrial capitalism is greater.

Until the early 1970s the Indonesian textile industry was dominated by merchant capital, although there were several fitful spurts in the movement towards manufacturing during the colonial and early post-independence period. The interaction between domestic and international factors encouraged the dominance of merchant capital until the late 1960s. The excessively rhetorical anti-foreign, socialist tone of domestic politics and the Cold War world-view that made Western governments, financial institutions, and investors cautious about committing money to the Indonesian economy, created foreign exchange shortages that made it difficult for the Indonesian government to pursue import-substitution industrialisation. Instead, it pursued the short-term goal of fulfilling basic requirements with imports so that textile manufacturers and small-scale weavers were forced to play second fiddle to textile traders.

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[1] Review of Indonesia, April 1955, 12-13; D.N. Aidit, "The Mobilization of Funds and Forces for Development," Speech before the Interdepartmental Funds and Forces Committee cited in Review of Indonesia, January-April 1964, 26.

As Gerschenkron notes, in the late developers it is the state that must make massive investments and create public enterprises to further import-substitution industrialisation where an entrepreneurial class is lacking.[2] But in the early stages, the Indonesian state lacked the economic resources and probably the inclination to participate directly in the industrialisation process. A shift towards industrialisation would have required far greater control and authority over society and the fiscal discipline to achieve that objective. China's success in that direction stemmed from the Communist system of governance. India's partial success in state-led industrialisation derived from its far superior capacity for resource mobilization. Such resources as Indonesia had it expended on extra-economic proclivities such as war-making. It was only after 1958, when the government, threatened by a rising Communist movement and by right-supported external forces, opted for Guided Democracy at the political level and state-supported industrialisation at the economic level.

The subordinate role of industrial capital to merchant capital was evident in a variety of relationships from independence until the late 1960s and early 1970s. It was evident in the relationship between the state trading corporations and the state industrial enterprises and the subordinate role of the Ministry of People's Industry with respect to the Ministry of Trade during Guided Democracy; in the dismal under-utilisation of domestic textile capacity while there was a brisk and robust trade in textile yarns and fabrics[3]; in the imports of huge quantities of finished textiles[4]; in the relationship between merchants and the small-scale weavers[5]; and in the overpowering presence of foreign merchant capital and the almost complete absence of foreign industrial capital.

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[2] Alexander Gerschenkron, Economic Backwardness in Historical Perspective (Cambridge, Mass.: Balknap Press, 1962).

Externally, the industry's linkages were with transnational merchant capital. The trading transnationals dominated Indonesian textile imports. Until 1958, when they were nationalised, the Big Five Dutch trading companies dominated Indonesian trade from the "historical rights" they derived via the Round Table Agreements. After 1958, the Indonesian state trading corporations which replaced the Big Five established links with the Japanese sogo shosha.[6]

The subordination of industrial capital was also evident in the relations between the state enterprises after Guided Democracy was inaugurated. For their supplies, the state textile manufacturing firms depended on the state trading corporations which did not give them priority.[7] For lack of foreign exchange the older enterprises could not buy spare parts and the newly- established firms could not complete plant and facility construction. In several instances, yarn supplies and capital equipment were stolen at the port of arrival. During the mid-1960s, although state enterprises controlled 75 percent of large-scale spinning capacity they could not fulfill their mandates for lack of funds. In late 1965, the state manufacturing enterprises, some financed with Japanese war reparations monies, stood under-utilised and half-finished monuments symbolising the state's pecuniary circumstances.[8]

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[3] Sumitro Djojohadikusomo, "Stabilisation Policies in 1955," Ekonomi dan Keuangan 12 (September 1956), 123.

[4] Bruce Glassburner, "Economic Policy-Making in Indonesia: 1950-1957," Economic Development and Cultural Change 10 (January 1962), 126-127.

[5] Ingrid Palmer, Textiles in Indonesia: Problems of Import Substitution (New York: Praeger, 1972), 203.

[6] State-owned company executive, interview by author, Jakarta, 21 January 1987.

[7] Palmer, Textiles, 240; Former high-ranking government official, interview by author, Jakarta, 14 February 1987.

In the literature on public enterprises it has been argued that state enterprises sometimes become powerful entities that the state is unable to control. The expansion of state enterprises into the economy does not always translate into expanded capacity for the state. State enterprises develop interests of their own which do not coincide with state policy and which may, indeed, undermine state policy.[9] Despite the Communist Party's demands for increased state control over the economy, the state sector was not the product of deliberate state policy. State enterprises were created to fill the void that followed the unexpected take-over of Dutch enterprises.[10]

The state trading companies became powerful entities when they came to monopolise textile imports from 1958-1963.[11] They were expected to provide secure supplies of low-priced yarn to weaving establishments, thus advancing industry. The state trading corporations did reduce the role of domestic and foreign private capital. But they were not effective in furthering the state's professed goals of advancing industrialisation and a pribumi capitalist class. These goals were undermined by corruption, by the structural control exercised by middlemen in the distribution and marketing networks, and the increasing public expectation that the trading corporations should be profitable enterprises.[12]

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[8] Leonard A. Doyle, "The Economic Structure and Problems of the Indonesian Textile Industry with Recommendations For Policy and Administration," Prepared under U.S. A.I.D./Djakarta, Personal Services Contract, No. AID-497-21, 16 February 1968, 14-15.

[9] For an excellent discussion of this issue see Dietrich Rueschemeyer and Peter Evans, "The State and Economic Transformation: Towards an Analysis of the Conditions Underlying Effective Intervention," in Bringing the State back In ed. Peter Evans, Dietrich Rueschemeyer, and Theda Skocpol (Cambridge University Press, 1985), chap. 2.

[10] On December 12 1957 the Chairperson of the National Council, Mr Roeslan Abdoelgani, stated, "We must not use the term nationalisation, because it implies a kind of promise of payment." cited in "Indonesia: The Dutch Go Back," Far Eastern Economic Review, 21 March 1963, 607.

[11] "Indonesia's Economic Challenge," Far Eastern Economic Review 14 February 1963, 312-315; The government reaffirmed this power in a financial note, submitted to parliament with the 1960 budget. Palmer, Textiles, 124.

The state trading corporations conducted a profitable business by taking advantage of speculation and hoarding, the by-products of scarcity.[13] Not only did they dominate the textile industry with their control over imports, but they undermined their mandate - the promotion of a domestic manufacturing industry. The state trading corporations made their largest profits from speculating on and hoarding imported yarn and the sale of finished textiles which they imported in huge quantities.[14] They took advantage of the subsidised foreign exchange which the government gave them so that they could distribute yarn to weaving enterprises at fixed low prices on the basis of physical capacity.[15] The latter they failed to do. While it was state policy to reduce the Chinese traders' control over distribution and retail networks, through close ties with them, the state trading corporations sold yarn and finished textiles' supplies.[16]

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[12] Doyle, "Economic Structure," 10-12.

[13] Jusuf Panglaykim, An Indonesian Experience: Its State Trading Corporations (Jakarta: Fakultus Ekonomi: Universitas Indonesia, 1967), 36-37.

[14] In 1963 differences of Rp. 30,000 per bale were recorded. Panglaykim, State Trading, 73.

[15] Palmer, Textiles, 145-46; 259. Panglaykim, State Trading, 73.

[16] Textile consultant, interview by author, Jakarta, 20 December 1986; Panglaykim, State Trading, 40, 55.

The merchant mentality seeks to reduce risks. The sale of poor quality textiles produced by small-scale weavers was a risky business. But there was a ready and thirsty market for standardised finished textiles. Why would the rational state trading corporation manager not take advantage of a subsidised foreign exchange rate and continue to import huge quantities of finished textiles and make huge profits by speculating on the price of yarn rather than subsidise the small-scale weaver even if this defied state policy?

The dominance of merchant capital was also evident in the relations between the merchants and the artisans in the post-independence period. This relationship can be traced to the colonial government's policies which did not encourage the development of a modernised and mechanised textile industry in the Netherlands East Indies. Since the 1830s, the East Indies had been selected to serve the Netherlands' textile industry located in Twente.[17] However, unlike its predecessor, the VOC, the colonial state did not pursue a deliberate policy to destroy the small-scale handloom sector.[18]

Since the 19th century weavers had been increasingly organised in the Bandung area under merchant capital.[19] The merchant's control over weavers had increased as they became dependent on imported yarn and as the domestic textile industry expanded. Unable to fulfill their subsistence requirements, peasants increasingly turned to weaving cloth for the Chinese retailers, the merchants who also supplied them with yarn imports on credit. Retailers and merchants cornered 50-70 percent of the profits.[20]

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[17] Palmer, Textiles, 19.

[18] Matsuo Hiroshi, The Development of Javanese Cotton Industry Occasional Papers Series No. 7 (Tokyo: The Institute of Developing Economies, 1970), 17-19.

[19] Ibid., 17.

The colonial state had made no attempt to change the structural relationship between artisans and merchants. Nor did the post-independence state succeed in changing this structural feature. The small-scale artisan did not make the transition to factory production during the colonial period or in the post-independence period.[21] After independence, the small-scale artisans remained dependent and indebted to Chinese traders, directly or indirectly through their front-persons, as they had during the colonial period.[22]

With some modifications involving partial protection from the state in the form of cheap credits and some raw materials from the state enterprises in the 1970s and 1980s, this structural feature remained an essential ingredient in the organisation of the small-scale weaving sector. Throughout the post-independence period the state failed to undermine the relationship between Chinese retailers and distributors and the small-scale weaving sector. The small-scale weavers never made enough profit to accumulate the capital to make the transition to factory production.

Who made the transition to factory production and how was it organised in the early post-independence period? Here too the process began in the colonial period. It was the merchant-manufacturers who made the transition to manufacturing in the 1930s. In response to the rise of reform liberalism at the end of the 19th century, the colonial state introduced measures to protect small-scale weavers from imports in the 1930s. In the Netherlands this policy grew out of a lengthy debate between "bleeding-heart" socialists and liberals who promoted the Netherlands' textile industry.[23] Socialist Deputy Van Kol played a significant role in these debates, as he had in mining matters.[24]

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[20] P. Sitsen, Industrial Development in the Netherlands (New York: Netherlands and Netherlands Indies Council of the Institute of Pacific Affairs, 1942), 25 cited in Richard Robison, Indonesia:The Rise of Capital (North Sydney: Allen and Unwin, 1986), 23.

Proto-industrialisation gave merchants the surplus capital to make the transition to manufacturing. Proto-industrialisation is a phase of dynamic change before the factory stage "dominated by the spread of rural domestic industry mass-producing various consumer goods for long-distance trade."[25] Since the late nineteenth century the weaving sector in West Java exhibited the features of classic proto-industrialisation based on the interaction between the family economy and merchant capital to be found in the putting-out system.[26] Merchants made this transition in several irregular waves. In the colonial period, the putting-out system gave merchants centralised control over manufacturing. Putting-out is a system in which merchants sub-contract work to smaller establishments. Merchants provide the weavers with raw materials and sell their products, cornering the bulk of the profits. The putting-out system gave merchants the surplus capital necessary to make the transition to factory production. The first transition to manufacturing followed the colonial government's policies to curb imports in the early 1930s. The second wave took place in the late 1930s when several Chinese merchants took over the production facilities of indebted artisans. Several newly-established Chinese merchant-manufacturers now proceeded to dismantle the putting-out system that they had previously encouraged and preserved.[27]

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[23] Ibid., 19.

[24] J.S. Furvinall, Netherlands India: A Study of Plural Society (Cambridge: Cambridge University Press, 1944), 144-145.

[25] Pat Hudson, The Genesis of Industrial Capital: A Study of the West Riding Wool Textile Industry c. 1750-1850 (Cambridge: Cambridge University Press, 1986), 12.

[26] Matsuo, Javanese Textile Industry, 17.

In the post-independence period merchants made several transitions to factory production. The first transition followed the introduction of protectionist measures in the early 1950s - the Benteng Program of 1950 and the Urgency Program of 1953.[28] The Benteng program aimed to promote an entrepreneurial class through trade, the Urgency program to further import-substitution industrialisation. These were policy responses to economic nationalist, anti-Chinese sentiment, which in the 1950s bordered on xenophobia. The Benteng Program restricted the Chinese role in retail and distribution and the Urgency program introduced special protection for small-scale weavers.[29] In 1958, after the Dutch enterprises were expelled, merchants made another major entry into manufacturing. This process continued fitfully through the 1950s and the 1960s.

But the indigenous pribumi class did not develop. The Benteng and Urgency Programs largely served to enhance the power of Chinese retailers and distributors and of the "Big Five" Dutch trading companies. What emerged was a rentier class, a class of brief-case or "dummy" importers and manufacturers, who served as front-persons for the "Big Five" during the pre-1958 period and for Chinese traders and manufacturers, to whom they sold their licenses for a commission or other financial benefits.[30] When the state reserved imports from Hong Kong, Japan, and Singapore for pribumi importers in the early 1950s, the Chinese traders were the actual beneficiaries because they had contacts in those countries.[31] As a consequence of these policies local capital consisted of three major class fractions - the merchants, their allied brief-case or dummy partners, and an isolated, subordinate class fraction of weavers.

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[27] For a detailed discussion of this transition see Palmer, Textiles, Chapter 1.

[28] John O. Sutter, Indonesianisasi: Politics in a Changing Economy: 1940-1955 Data paper No. 36. 4 Vols. (Ithaca, N.Y.: Cornell University, 1959), 1171. Prime Minister Natsir's Minister of Trade and Industry, Sumitro Djojohadikusomo, initiated the Urgency Economic Plan (Rentjana Urgensi Perkonomian) which gave priority to manufacturing industries. Ibid, vol.3, 772-73.

[29] For an excellent discussion see Charles A., Coppel, Indonesian Chinese in Crisis (Melbourne: Oxford University Press, 1983), 37.

During the post-1958 period, the Chinese traders and manufacturers established close ties with the Japanese sogo shosha (general trading companies) who were their suppliers of yarn and finished textiles.[32] This relationship would serve them well when the Japanese sogo shosha became harbingers of foreign investment. Chinese merchants, with or without the aid of a front person integrated domestic marketing operations - imports, wholesale, distribution, and retailing. After paying their front person, merchants captured all the profits.

If the economic structure allows merchants to make the largest profits, there is little incentive for them to integrate backwards into industry. Consequently, the government's import-substitution industrialisation program floundered. The merchant-manufacturers did not relinquish their merchant role from which they derived their largest profits.[33] The economy's bias towards trade, hoarding, and speculation served as a disincentive for them to wish to seek their profits entirely from manufacturing. High yarn prices, yarn shortages, and the resulting under-utilisation of existing capacity did not encourage huge investments in manufacturing when survival itself was difficult.[34] Even the relatively large Chinese textile enterprises had not invested enough capital in plant and facilities to compete effectively with imports. They also had not accumulated enough surplus capital to adopt the new technology for more efficient mass production. Linked by filial ties to the Chinese in Hong Kong they obtained second-hand machinery from there.[35]

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[30] Anspach, "Indonesia," 167; Jusuf Panglaykim, "Indonesia: State Trading and Private Enterprise," Far Eastern Economic Review, 24 January 1963, 159-162; A.M. de Neuman, "On the Promotion of Indigenous Indonesian Industries with Special Reference to Credit Facilities for Private Businesses and for Local Government Enterprises," Economi dan Keuangan Indonesia 9 (1956) 683-728.

[31] Textile consultant, interview by author, Jakarta, 15 December 1986.

[32] Former high-ranking government official, interview by author, Jakarta, 14 February 1987.

The manner in which merchants established their manufacturing facilities prevented them from producing products that would halt imports. A minority of merchants invested in new productive capacities. These merchant manufacturers did make investments in mechanised power looms and they did achieve some economies of scale. Many merchants acquired the existing capacities of small bankrupt enterprises. This factor in and of itself rendered the transition to efficient mass production with the newer technologies redundant.[36] To a degree, the latter strategy can be compared to the merger and acquisition form that a predominant share of foreign direct investment has taken in the 1980s and 1990s where transnationals have acquired existing capacities instead of investing in new productive and physical capacities.

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[33] Pos Indonesia, 2 January 1959, cited in Kho Sam To, Kho Sam To, "Textile Cloth Retailing in Djakarta," (Master's diss.: Fakultas Ekonomi: Universitas Indonesia, 1959), 25.

[34] Textile consultant, interview by author, Jakarta, 20 March 1987.

[35] Ibid.

[36] Doyle, "Economic Structure," 12.

The KOTOE program of May 1963 was introduced to distribute yarn to authentic manufacturers according to physical capacity.[37] But many of the "so-called" manufacturers were actually brief-case manufacturers who did not own equipment. Instead, they made their millions in rupiah terms by selling their yarn on the black market where the price was 2000 percent higher than the government price by the end of 1965.[38]

> Getting a license was a combination of political affiliation and political entrepreneurship. The license on occasion had great economic value. In technical economic terms, it was worth the discounted present value of anticipated profits.[39]

The larger enterprises managed to remain marginally profitable although but they could not utilise their capacity fully or compete with imports from Hong Kong and Japan. As Doyle points out, the cloth produced by the top mechanised weaving firms such as P.T. Daya Manunnggal, a Chinese manufacturing firm which was to become the largest Indonesian textile conglomerate in the 1970s, displayed physical flaws, sometimes in every yard.[40] Measured against the handloom sector, the modern sector had done well. It was another matter when its performance was measured against the quality produced in Japan and Hong Kong, the home of Indonesia's imports. The main point in all of this is that the economic structure remained biased towards trade, which served as a disincentive for traders to move to industry.

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[37] President, local textile firm, interview by author, Jakarta, 16 December 1987.

[38] Ibid.

[39] Doyle, "Economic Structure," 15.

[40] Ibid., 18.

At the end of the 1960s, the industry looked very much like it had during the final colonial years. The small and medium-sized firms trailed behind the large-scale firms in their knowledge of the market, consumer preferences, and technique, a problem that the Benteng, Urgency, and Kotoe programs had failed to address. Raw materials imports required large amounts of capital and knowledge of overseas markets. The contacts of the small and medium-sized firms were limited to the traders who sold them yarn, gave them advance payments, and bought what they weaved.[41] A characteristic of the textile industry is that several isolated markets emerge which are supplied by separate categories of producers. The market is an exacting despot. Small and medium-sized firms were unable to establish a niche for themselves in the markets supplied by the larger firms. And the larger domestic manufacturing firms could not compete with imports. Import-substitution industrialisation was stunted.

It was not that state managers had not given serious thought and consideration to the import-substitution industrialisation program. Government policy throughout the 1950s and the early 1960s had displayed an earnest obsession with import-substitution industrialisation. State managers and their opponents were all concerned that an indigenous class of some substance had failed to emerge and about the dismal under-utilisation of domestic capacity.[42] The Communist Party consistently complained about the pseudo-national importer, the under-utilisation of capacity, and the need to develop an indigenous entrepreneurial class even if this involved the whitening of hot money. But the state had been unable to dismantle the predominance of merchant capital. And it had been unable to finance import-substitution industrialisation itself.

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[41] Review of Indonesia, February 1958, 23.

[42] See for instance O.G. Roeder, "Interview with Cheirul Saleh," Far Eastern Economic Review, 24 December 1964, 604.

After 1967 it became the task of transnationals to undermine merchant capital and to trigger the transformation of the merchant-manufacturers and traders into industrial capitalists. Local capital would now climb the "learning curve" through interactions with foreign capital, a subject that I discuss in the next chapter.

Section II

In 1967 the Indonesian government invited foreign textile transnationals to invest freely in the country. This decision was the product of domestic and international pressures. Internationally, the government was responding to the dictates of Western governments and international financial institutions which were withholding aid until the bureaucratic-authoritarian regime liberalised the foreign investment climate. Domestically, by the late 1960s it was clear that while the domestic industry had expanded, it was unable to compete with imports. As yet, the achievement of import-substitution industrialisation was not an offensive measure to capture foreign markets. It was a defensive strategy to halt the inflow of foreign textiles by achieving import-substitution industrialisation.

In its anxiety to create favourable conditions for foreign investors, to promote import-substitution industrialisation, and to dispel the negative perceptions of Indonesia's political and economic climate formed by the international capitalist community during the Sukarno era, the Indonesian government chose not to bargain with foreign investors in the 1967-1974 period. The interaction between the Indonesian state and textile transnationals did not run the same course as it did in the case of the oil multinationals. There was initially hardly any controversy about the entry and presence of textile transnationals in Indonesia. Whereas in the case of oil, transnationals sought and only grudgingly were granted concessions in Indonesia, the textile transnationals were welcomed with a near open-door policy by the Indonesian state.

Since there was no controversy, there was consensual bargaining between the state and the transnationals. In the case of state-textile transnational interactions, the consensus resulted from a variety of factors. In the first place, the failure of the Indonesian textile industry either to achieve large-scale production for the common people or fine quality material/garments for the upper and lower middle classes, provided the objective conditions for the entry of (and invitation to) the transnationals. If the only two effective options were either to import cloth or to attract textile transnationals, the latter was probably the more rational and less painful option. A second, and perhaps far more important factor, was that those political groups and forces with ideological or radical nationalist objections to the entry of transnationals had been effectively marginalised, indeed forced out of the political arena by a reign of terror against the PKI and other radical groups.

In a sense, the entry of the transnationals was taken to be a non-conflictual political issue. Bachrach and Baratz argue against taking only politicised issues into consideration: "By presupposing that...there are significant issues in the political arena,

[it] takes for granted the very question that is in doubt. [It] accepts as issues what are reputed to be issues."[43] In this case, it was not weakness but convergence of interests that induced the government not to bring conflictual issues to the bargaining table.

Stepan notes that the state is in the weakest position to control foreign capital, in those sectors where foreign investment has a high priority in the state's development plans and foreign investment is still uncommitted to the sector.[44] Then governments will offer concessions upon entry, subsidies, tariff concessions, and even non-tariff barriers that discriminate against domestic firms.[45] The government adopted the classic weak bargaining position that host governments adopt in industries where the viability of the project is still unknown. This weakness stems from the host country's impression of the cost of supplanting or foregoing the benefits of the transnational's presence compared to its own store of technical skills, bargaining capabilities, and power. In other words, it was willing to pay a high supply price to foreign investors for their firm-specific assets. Not a thought was expended on eroding them. The Indonesian government did not conduct industry-by-industry analysis to determine the bargaining flexibility that it could avail in the textile industry as opposed, for instance, to the mining industry. Moran argues that the size of the local market, the degree of sophistication of the bureaucracy, and the extent of social mobilisation have a significant impact on the bargaining power of host governments. The objectives of government officials are extremely significant to determine whether these resources will be translated into potential power.[46] In Indonesia, the large domestic market which should have added to the government's bargaining power became a meaningless resource. Even if Indonesian officials had the skills to negotiate with foreign investors, they would not have negotiated more favourable terms for the simple reason that this was not their objective.

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[43] Peter Bachrach and Morton S. Baratz, "The Two Faces of Power," American Political Science Review 56, no.4 (December 1962), cited in Susan Strange and Roger Tooze, "States and Markets in Depression: Managing Surplus Industrial Capacity in the 1970s," in The International Politics of Surplus Capacity, ed. Susan Strange and Roger Tooze (London: George Allen & Unwin, 1981), 9.

[44] Alfred Stepan, The State and Society: Peru in Comparative Perspective (Princeton: Princeton University Press, 1978). Other cases have shown that Stepan's bargaining cycle model is not fully applicable. See for instance, Gary Gereffi, "The Renegotiation of Dependency and the Limits of State Autonomy in Mexico (1975-1982)," in Multinational Corporations: The Political Economy of Foreign Direct Investment, ed. Theodore H. Moran, (Lexington, Mass.: Lexington Books, D.C. Heath, 1985), 98-100.

[45] Stepan, State and Society, 39-40.

Scholars such as Bennette and Sharpe and Gereffi argue that host governments can stipulate stringent regulatory framework for foreign investors if transnationals find the investment climate sufficiently attractive at the time of entry. The host government derives its bargaining power from its location-specific advantages such as a large domestic market and cheap labour. They argue that unlike the natural resource sector, in the manufacturing industry a host government's bargaining power is at its peak when projects are initiated and tends to ebb once the investment is sunken.[47]

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[46] See Richard S. Newfarmer, Transnational Conglomerates and the Economics of Dependent Development: A Case Study of the International Electrical Oligopoly and Brazil's Electrical Industry Contemporary Studies in Economic and Financial Analysis, Vol. 23. (Greenwich, Conn.: Jai Press, 1977), 12.

[47] Gereffi, "Renegotiation of Dependency," 101; Douglas C.Bennette and Kenneth E. Sharpe, Transnational Corporations Versus the State: The Political Economy of the Mexican Auto Industry, (Princeton: Princeton University Press, 1985), 106. also see Douglas C.Bennette and Kenneth E. Sharpe, "The World Auto Industry and Its Implications for Developing Countries in Latin America," in Profits, Progress, and Poverty: Case Studies of International Industries in Latin America in R. S. Newfarmer (Notre Dame: Notre Dame University, 1985), 219, 221-222.

It is at the time of entry that host governments can institute a regulatory framework and impose performance requirements on foreign investors to monitor their activities and to ensure that they are pursuing the terms and conditions stipulated at the time of entry and that the local economy is benefitting from them.[48] Host governments can insist on fifty percent or majority ownership for domestic and state-owned local firms, the transfer of key management positions to nationals, and the transfer of technology to further domestic capital accumulation. Governments may allow that this be a gradual process spanning 10-15-20 years but based on the long-term underlying assumption that local private and public firms and professionals of national origin will eventually displace foreign firms and their managerial staff.[49]

However, the broad generalisation of the heightened bargaining power of the host government at the time of the entry of the foreign firm is not always valid. Of course, scholars such as Bennette and Sharpe do qualify the generalisation with the caveat that the industry structure, historical structural factors, and competition may negate the inference. As I will show in this and the following two chapters, the Indonesian textile industry, an industry with relatively standardised technology compared to an industry with changeable and sophisticated technology such as computers, the state's bargaining power increased in a manner similar to that depicted in natural resource industries. But even in high-tech industries, as Grieco shows in his case study of India, the government's bargaining power can increase over time.[50]

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[48] Ibid.

[49] For a detailed discussion of these issues see United Nations Centre on Transnational Corporations, Joint Ventures as a Form of International Cooperation, Background Documents of the High-Level Seminar Organised by the United Nations Centre on Transnational Corporations in Cooperation with the State Foreign Economic Commission and the State Commission on Science and Technology of the Union of Soviet Socialist Republics, Moscow, 10 March 1988 (New York: United Nations, 1988), 48.

The Indonesian state was weak when foreign investors entered the manufacturing sector but its bargaining power increased over time. Consequently, it is necessary to evaluate the power of the state according to the characteristics of the industry and project. Moran argues:

> ...as long as MNC operations in the 1980s embody some combination of large fixed investment, stable technology, standardised marketing, and increasing competition, the bargaining position of the host government will grow stronger, and their agreements will bring greater benefits to the third world.[51]

Domestic factors augured well for foreign investment.[52] Liberal economics, the basis for technocratic economic policy-making of the early New Order years in the non-petroleum sectors, provided no room for host government/foreign investor bargaining. It promised and delivered a hands-off approach. As Moran would argue, the government remained "mystified".[53] The Bappenas (National Development Planning Board) position with regard to the non-strategic sectors which included mining was later explained by Mohammad Sadli, then Chairman of the Investment Coordinating Board:

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[50] See Grieco's study of the Indian computer industry. Joseph M. Grieco, "Between Dependency and Autonomy: India's Experience with the International Computer Industry," in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. Theodore Moran (Lexington: Lexington Books, 1985), 55-82. Also see Peter B. Evans, "State, Capital, and the Transformation of Dependence: The Brazilian Computer Case," World Development 14 (1986), 791-808.

[51] T.H. Moran, "Multinational Corporations and Third World Investment," in Latin America: Dependency or Interdependence ed. Michael Novak and Michael P. Jackson (Washington D.C.: American Enterprise Institute for Public Policy Research, 1985), 18.

[52] P.T. Data Consult Inc, "Business Report: Study of the Indonesian Textile Market: Justification Report for the Expansion of P.T. Dan Liris, Solo," Prepared for Multinational Finance Corporation, Jakarta, 16 October 1981.

[53] Theodore H. Moran, Multinationals and the Politics of Dependence: Copper in Chile (Princeton: Princeton University Press, 1974), chap. 6.

> When we started out attracting foreign investment in 1967 everything and everyone was welcome. We did not dare to refuse; we did not even dare to ask for bonafidity of credentials. We needed a list of names and dollar figures of intended investments, to give credence to our own drive. The first mining company virtually wrote its own ticket. Since we had no conception about a mining contract we accepted the draft written by the company as the basis for negotiations and only common sense and the desire to bag the first contract were our guidelines.[54]

A host government with scanty experience in bargaining with transnationals begins with sparse knowledge of the terms that it can impose on foreign firms. As a consequence it makes little distinction between industries that utilise standardised technology compared to the high-tech manufacturing industries where technology is rapidly changing. Its bureaucracy may have little knowledge of the kinds of incentives that other countries give to foreign investors.[55] It therefore has no basis for comparison. The bureaucracy may be unable to analyse the transnationals' feasibility studies meaningfully or it may not even request them. It may just be so pleased to have foreign investors that it looks the other way when they enter. This was the position of the Indonesian state when it passed the Foreign Investment law in 1967.

The Indonesian Foreign Investment Law was designed to attract investment by providing fiscal incentives, transfer guarantees, legal security against nationalisation, procedures for dispute settlement, and assurances for management autonomy. Direct foreign investment was considered necessary to increase productivity in mining and manufacturing where foreign investors were allowed 100 percent equity ownership. Companies embarking on new projects were exempted from taxes generated on profits during the first six years of operation, and import duties on raw materials and initial capital equipment. Companies were given a four-year tax holiday and they could depreciate machinery over fifteen years although accelerated depreciation was also acceptable.[56] Losses incurred during the tax holiday period could be recouped by profits earned subsequently. The law applied to all sectors in the non-oil sector except banking. The foreign trade regime was liberalised to make raw materials and capital goods more easily available to industrialists in contrast to the late 1950s.[57]

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[54] Cited in Ingrid Palmer, The Indonesian Economy Since 1965 (London: Cass, 1978), 100. This relatively careless attitude towards the non-oil sector was also a colonial legacy.

[55] Moran, Politics of Dependence, chap. 6.

A majority of the foreign and domestic investments in the late 1960s and early 1970s were in the textile industry, which served as the harbinger of industrial development in Indonesia. The eighteen Japanese joint ventures that were established in Indonesia, accounting for half the total Japanese investments in the country, were made between 1970-1973 when the regime for foreign investors was the most liberal.[58]

But domestic factors alone were not responsible for the rapid influx of foreign investment. Changing international factors also played a significant role. Under the direction of Japan's Ministry of International Trade and Industry Japanese industry and government policy became outward-oriented. International and domestic factors in Japan's domestic environment generated an impulse for direct foreign investment. Japan had a balance of payments surplus with capital gearing to find an outlet. Labour shortages, wage increases, and a high degree of public awareness about environmental issues[59] combined to create a momentum for the transfer of Japanese smoke-stack factories to other parts of the world where there was abundant cheap labour.

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[56] President, Japanese textile transnational, interview by author, Bandung, 19 July 1987.

[57] Ibid.

[58] Japan External Trade Organization, "List of Japanese Investment Projects in Indonesia," 1986.

The Japanese government implemented several liberalisation measures to promote Japanese investment in foreign countries.[60] It liberalised monetary policy, dismantled some trade barriers to encourage the import of goods produced by Japanese firms in foreign countries into Japan, and it instituted a liberal lending program to reduce Japan's foreign currency reserves.[61] The EXIM Bank reduced interest rates for foreign investors and the Japanese government liberalised the regulations to ease overseas expansion between 1969 and 1972.[62] Consequently, Japan's total global direct investment grew from a little less than $300 million in 1970 to $3.5 billion in 1973.[63] For Asia, Japan's investment expanded from a little less than U.S.$100 million in 1970 to U.S.$1 billion in 1973.[64] In Asia, Japanese investment reached its peak in 1973.[65]

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[59] The Export-Import Bank of Japan, Tokyo, "Japan's Direct Investment for Asia: With Emphasis on Investment in Manufacturing Industries," Monthly Bulletin of the Research Institute of Overseas Investment (June 1985), 7.

[60] Ibid., 7-9.

[61] Ibid.

[62] Ibid., 7.

[63] Ibid., 13.

[64] Ibid.

[65] Masahito Ikeda, "Trends of Japan's Investment for Asia," Exim Review (Japan), 6 (1985), 72.

Firms derive a bargaining advantage with respect to host governments when there is competition among neighbouring countries vying for foreign investment. This enables firms to extract better entry terms. Japanese textile enterprises began their entry into Thailand in 1963, Taiwan in 1966, Korea and Singapore in 1969, Indonesia in 1970, and Malaysia in 1972.[66] The conditions for foreign investment were simultaneously improved in Korea, Singapore, Indonesia and Malaysia.[67] Foreign capital was promoted through high tariffs and restrictions on import volumes.[68]

Japanese investors also came with high hopes. Indonesia offered a huge domestic market of 120 million people. The Indonesian government's objectives to prevent imports and to encourage investors to produce textiles for the domestic market coincided with the Japanese textile industry's need to prolong its profitability in what was becoming an increasingly sunset industry with aging technology.[69] The Japanese textile industry was a declining industry facing intense competition from the rising textile industries in Korea and Taiwan.[70]

According to Vernon's product cycle model, as technology in an industry becomes standardised, firms are likely to face greater difficulty in reaping oligopolistic rents.[71]

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[66] Ibid.

[67] The Korean government enacted the Foreign Capital Inducement Act in 1966; Singapore enacted the Economic Expansion Incentives Act in 1967; Indonesia passed the Foreign Capital Investment Law; and the Malaysia government passed the Investment Incentives Act in 1968. The EXIM Bank of Japan, "Japan's Direct Investment," 6.

[68] Ibid.

[69] State-owned company executive, interview by author, Jakarta, 6 February 1987.

[70] Ibid.

[71] Raymond Vernon, "International Investment and International Trade in the Product Cycle," Quarterly Journal of Economics 80 (May 1966), 190-207.

To build upon that basic assumption it can be argued that firms can utilise two strategies to remain competitive as the market for their product becomes more competitive. They can invest in technological innovations to maintain an edge over their rivals or they can prolong their oligopolistic rents through foreign direct investment in countries with imperfect markets with high tariff and non-tariff barriers. This latter strategy not only enables industrialising countries to move to a higher position in the hierarchy of the world capitalist system but it also enables the firm to continue to extract oligopolistic profits. Masahito Ikeda found that in the initial years Japanese firms were profitable because they entered the Asian market early and they benefitted from various "protection/encouragement" policies.[72]

The internationalisation of the major textile manufacturers - Toray Industries Inc., Toyobo Ltd., Teijin Ltd., Mitsubishi Rayon Co. Ltd., Asahi Chemical Ltd. - was closely linked to the activities of the sogo shosha.[73] In the first half of the 1950s, their primary thrust had been to establish sales affiliates. The sogo shosha had long been involved in the worldwide provision of goods and services, marketing, financing, and project organisation. But from 1956 onwards, and particularly during the 1960s the number of manufacturing affiliates in Asia and Latin America proliferated.[74] Ozawa has commented that in the 1960s and the early 1970s Japanese investment clustered in Asia and Latin America. A high proportion of Japan's foreign investors were small and medium-sized firms. These firms were more responsive to establishing joint ventures with industrialising country rather than industrialised country firms.[75]

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[72] Masahito, Ikeda, "Trends of Japan's Investment for Asia," Exim Review (Japan) 6 (1985), 70.

[73] President, Japanese transnational, interview by author, Jakarta, 22 December 1986; Japanese diplomat, interview by author, Jakarta, 19 December 1986. Also see United Nations Centre on Transnational Corporations, Transnational Corporations in the Man-Made Fibre, Textile and Clothing Industries (New York: United Nations, 1987), 35.

[74] For excellent discussions of the role of sogo shosha see Alexander K. Young, The Sogo Shosha: Japan's Multinational Trading Companies (Tokyo: Charles E. Tuttle Company, 1986). Yoshi Tsurumi, Sogoshosha: Engines of Export-Based Growth

The Japanese sogo shosha served as the harbingers of foreign investment in Asia and Latin America and as bond-makers between the local and the Japanese manufacturing partner. The sogo shosha invariably participated in these ventures. The manufacturing companies' small size made them risk averse which enhanced the importance of the sogo shosha linkage. The sogo shosha participated in these ventures to counteract the loss of finished fabric and yarn export markets that they had previously controlled in the host countries as Yasumuro explains,[76] and because they already had well-established contacts in the host country and were able to link the Japanese investors with reliable partners as Tsurumi notes.[77] Their primary interest was to handle exports from and to the affiliates for which they provided these small firms with capital:

(Montreal: The Institute for Research on Public Policy, March 1980).

[75] Terutomo Ozawa, "International Investment and Industrial Structure: New Theoretical Implications from the Japanese Experience," 31 Oxford Economic Papers, 72-92.

[76] Yasumuro noted that when Kanebo, Toyobo, and Kurabo invested in the Latin American textile industry in the early 1950s, the sogo shosha participated in joint ventures to circumvent the loss of their export markets. Ken'ichi Yasumuro, "The Contribution of the Sogo Shosha to the Multinationalization of Japanese Industrial Enterprises in Historical Perspective," in Overseas Business Activities ed. Akio Okochi and Tadakatsu Inoue (Tokyo: University of Tokyo Press, 1984), 78-79.

[77] Yoshi Tsurumi, "Japanese Investments in Indonesia: Ownership, Technology Transfer, and Political Conflict," in The Indonesian Economy ed. Gustav F. Papanek (New York: Praeger, 1980), 295-323. In my interviews both factors were considered influential.

> Mitsui, our shareholder introduced our parent, Toray, to its previous Indonesian buyers who were experienced in the textile industry. Mitsui convinced Toray that Indonesia was a good market for textile production. After the decision was taken to establish a factory, it was decided that all imports would be made through Mitsui for a 2-3 percent commission on the invoice.[78]

A notable feature of Japanese foreign investment is the relationship between the sogo shosha and the Japanese manufacturing firm. Since the prime rationale for their existence was to buy and sell, the Japanese sogo shosha were in most cases prepared to accept a 20-30 percent minority share with respect to their Japanese manufacturing counterpart. They did not in general demand the preponderant shares in their partnerships with Japanese manufacturing companies. They were reluctant to participate directly in the management and control of the enterprise.[79] And perhaps with their strength they had no need to do so.

A major strategy adopted by the major Japanese textile transnationals was to capture that segment of the domestic market or export quota where there were few or no competitors, where they could provide superior quality, or through vertical integration, compete on price. Small transnationals using standardised technology transnationals develop strategies uniquely attuned to their market niches and can utilise the flexibility and "easily transferable know how and know why" to maintain their profitability.[80] In addition, these firms adopt specific strategies that enable them to compete or find suitable niches shielded from the competitive blast of conventional transnationals.[81]

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[78] President, Japanese transnational, interview by author, Jakarta, 22 December 1986.

[79] I came to this conclusion based on interviews and a perusal of the ownership structure of Japanese investments. For the latter see JETRO, "List of Japanese Investments," 1986.

[80] Peter J. Buckley, The Multinational Enterprise (Houndmills: Macmillan, 1989), 84-85.

These firms came to Indonesia to avoid tariff barriers and to pre-empt their competitors from monopolising the market. "When competition is fierce, as in the case of synthetic fibres, one firm's move to enter Indonesia was immediately followed by its competitors."[82] In the case of these firms it is possible to explain Japanese investment by combining Knickerbocker's theory of "defensive oligopoly"[83] with Hymer's theory of oligopolistic advantage. Upon entry, the first entrants outlined their conditions in their first encounter with the Indonesian government. They sought high tariff and non-tariff barriers. The Japanese investors were quite pleased with the existing foreign investment climate.[84] "The government increased tariff barriers and limited production through its control over licensing so that the industry could flourish."[85]

Hymer had argued that foreign investors require certain advantages over domestic firms to extract oligopolistic rents. They tend to invest in those industries where the barriers to entry are the highest. As early entrants into the market the major Japanese investors captured the staple polyester fibre and nylon filament market. They satisfied their raw materials and capital equipment requirements from their parent companies channelled through their sogo shosha partners. This was also the sector which was least subject to regulation in the supply of raw materials. With no domestically available production, the joint venture could deal directly with their parent companies or their sogo shosha affiliates to obtain raw materials supplies. Here there was room for transfer-pricing and other benefits that firms derive from internalisation.[86]

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[81] Ibid.

[82] Yoshi Tsurumi, "Japanese Investments," 301.

[83] Frederick T. Knickerbocker, Oligopolistic Reaction and Multinational Enterprise (Boston: Harvard University School of Business Administration, 1973).

[84] President, Japanese transnational, interview by author, Jakarta, 22 December 1986.

[85] Ibid.

> Internalisation is the process of making a market within a firm. The internal market of the firm substitutes for the missing regular (or external) market and solves the problem of allocation and distribution by administrative fiat. The internal prices (or transfer prices) of the firm lubricate the organisation and permit the internal market to function efficiently as a potential market. Wherever there is a missing market or when the transaction costs of the regular market are excessive, then there will be a reason for internalisation.[87]

It is commonly and mistakenly believed that all segments of the textile industry are characterised by low capital and technology intensity and a high degree of fragmentation. These features correctly describe all downstream segments of the industry beginning with yarn production. But they do not apply to the synthetics fibre segment of the industry. By the end of the 1970s, the 12 largest firms produced close to three-fifths of the world's synthetic fibres and accounted for 80-90 percent of international trade. High concentration is associated with entry barriers to the industry: heavy investments to retain competitiveness; economies of scale; advanced technology and heavy expenditure on research and development; patent protection which had made it difficult for outsiders to enter the industry.[88]

Although the Japanese firms were the first to make an entry into Southeast Asia's textile industry, they were not alone. Firms from Hong Kong and India also entered the Indonesian textile industry through out the mid-1970s to the early 1980s. The changing patterns of world trade and comparative advantage, combined with the policies of certain countries to foster the internationalisation of their textile industries, led to the emergence of a number of developing country firms. Some were large by world standards. The world's largest 250 textile firms in 1984 included 15 Korean and 8 Taiwanese firms, 4 from Hong Kong and 13 from India. Industrialising country firms are motivated by the same factors that drive industrialised country transnationals, market imperfections and locational variables - low labour costs, tariff and non-tariff barriers in host country markets and quota jumping.[89]

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[86] For the operationalisation of internal markets see, Peter J. Buckley and Mark Casson, The Future of the Multinational Enterprise (London: Macmillan., 1976); Alan M. Rugman, Inside the Multinationals (London: Croom Helm, 1981), esp. 25-58.

[87] Rugman, Inside the Multinationals, 28.

[88] The patent on nylon stayed in place until 1966 and for polyester until 1968. UNCTC, Transnationals in Textile and Clothing, 49.

Indian companies invested in Indonesia for several reasons. A representative of the Birla conglomerate noted: "after the Indian government passed The Monopoly and Restrictive Trade Practices Act,[90] the large Indian conglomerates (such as Tata and Birla) preferred to invest outside the country because our growth was restricted domestically. We established headquarters in Switzerland and the Bahamas so that we could transfer our profits without facing the Indian government's restrictions."[91] Indian companies were also attracted by subsidised fuel in plentiful quantities when the oil-importing Indian government was restricting energy consumption following the 1973 oil crisis. They saw Indonesia's absence of exchange controls, large population, and cheap labour as added incentives.[92] "At the time we invested in Indonesia, there were no quotas on exports to the United States. Money was flowing into a sound economy. Compared to the Indian government, the Indonesian government was liberal. There was political stability. The only problem was that we had to train workers."[93]

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[89] UNCTC, Transnationals in Textile and Clothing, 44. Several scholars have sought to distinguish developing and developed country firms. Developing country firms are often portrayed as more benign, that is they are seen to understand economic nationalism better, transfer more appropriate technology. But the results are mixed. See for instance Louis T. Wells, "Small-Scale Manufacturing as a Competitive Advantage," in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. Theodore H. Moran, (Lexington, Mass.: Lexington Books, D.C. Heath, 1985), 119-136.

[90] Sanjaya Lall, "Multinationals form India," in The New Multinationals: The Spread of Third World Enterprises ed. Sanjaya Lall (Chichester: John Wiley & Sons, 1983), 44-45.

The prime motivation for Hong Kong firms to invest in Indonesia's textile industry came from the international trade regime after the 1974 Multi Fibre Agreement(MFA) was established which raised entry barriers for Hong Kong textiles in several industrialised countries. Rising rents and labour costs in Hong Kong also spurred foreign direct investment.

By world standards Indonesian subsidiaries were small in size. The strategy adopted by these relatively small,[94] import-substituting subsidiaries in developing countries was very different from the strategy that export-oriented subsidiaries pursued in countries such as Taiwan and South Korea. A decade later the problem that would come to haunt foreign subsidiaries and the Indonesian government was how to transform their high-cost, unprofitable, highly-protected, import-substituting subsidiaries into lucrative, thriving export-oriented plants, an issue to which I will return later.

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[91] Corporate executive, Indian transnational, interview by author, Jakarta. 13 July 1987.

[92] Ibid.

[93] Ibid.

[94] The size of a Japanese subsidiary as well as other foreign subsidiaries was typically a third or two thirds the size of a Japanese subsidiary in Taiwan or its own parent company. Textile consultants, interview by author, Jakarta, 17 March 1987.

Major development in textile machinery and versatile textiles did not exist at the time. So import-substitution was achieved with standardised technology and machinery.[95] These import-substituting firms did not come to provide variety, fancy fabrics, distinctive yarn mixes or fibres. Indeed, the fact that the "Indonesian textile industry did not require a high degree of technique was a positive incentive for us to invest here."[96] They came to produce or provide the raw materials for basic grey, finished cloth that would satisfy a large number of poor people. Foreign companies produced B and C grade for the domestic market since price-competitiveness was the over-riding concern.[97] "Teijin mainly produced plain grey cloth. The company only had a few self-design machines because management preferred not to go to the trouble of producing high-cost fabric which would require a great deal of technical expertise and for which there was not much demand."[98]

In the absence of bargaining and "governance," domestic groups will be more vulnerable "to the power structures of the market and to all the forces that dependency writers and structuralists insist upon."[99] In the first encounter the state saw its primary role as a referee: it was creating the conditions for capital accumulation in a stable political and economic environment. This was its goal and its objective. The government would brook no interference with these basic assumptions and its bureaucratic-authoritarian nature gave it the means to do so.

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[95] Textile consultant, interview by author, Jakarta, 6 January 1987.

[96] President, Japanese transnational, interview by author, Jakarta, 29 December 1986.

[97] Ibid.

[98] Corporate executive, Japanese/Indonesian textile joint venture, interview by author, Bandung, 17 July 1987.

[99] Strange and Tooze, "States and Markets," 8.

The state's autonomy with respect to civil society increases considerably when it achieves the capacity to move against popular forces during periods of increasing class conflict. As the state takes a more active role in repressing subordinate groups, it is more willing to move against dominant groups as well. Although the regime was creating favourable conditions for capitalist accumulation, the domestic entrepreneurial class was not strong enough to determine the terms and conditions for capital accumulation. There was no room for even the more sympathetic form of entrepreneurial political activity, let alone populism. This is what O'Donnell means when he portrays the bureaucratic-authoritarian regime becoming deaf to the demands of the local bourgeoisie.[100] But domestic investors had also not pushed to obtain a greater equity share, perhaps because they were afraid that even this might be viewed as opposition to the new regime's policies.

The state did not seek to pursue an active role in furthering the Indonesianisation process or in instructing transnationals to select specific joint-venture partners. The Indonesian state's desire to maintain a non-activist role in regulating foreign capital combined with the domestic entrepreneurial class's lack of capital and technical skills gave foreign investors a free hand in establishing majority joint ventures.[101] Foreign investors were given guarantees and incentives to make the Indonesian climate attractive of which the shareholding issue was one.

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[100] Dietrich Rueschemeyer and Peter Evans, "The State and Economic Transformation: Towards An Analysis of the Conditions Underlying Effective Intervention," in Bringing the State Back In ed. Peter Evans, Dietrich Rueschemeyer and Theda Skocpol (Cambridge: Cambridge University, 1986), 63.

In pre-1974 the Indonesian state did not specify the transnationals' requirements for entry. Both Japanese and Indian investors, who in a majority of their overseas foreign joint ventures in other countries willingly accepted minority shareholding, had majority ownership in their Indonesian ventures.[102] Japanese subsidiaries in Indonesia, unlike the vast majority that were analysed by the Harvard University study on Japanese multinationals, were initially majority-shareholders.[103] In a survey of Indian investment, Asian Finance noted that Indian foreign investors generally accepted "minority participation" almost as a rule. An official survey showed that Indian partners were in a minority in 83 percent of joint ventures established abroad. One reason was that the Indian government restricted capital outflows and it had therefore linked the idea of overseas joint ventures to promoting capital equipment and technology exports.[104]

When the state bargains in the manufacturing sector, and when public enterprises do not play a dominant role in setting industry priorities and reaping its profits, the state is one step removed from savouring the direct benefits from the bargains that it strikes with transnational corporations. With the exception of taxation, balance of payments, and political legitimacy concerns, in its bargains the state seeks private local capital accumulation. This is unlike the natural resource sector where the state enterprise strikes bargains for itself and the state to control the surplus and the activities of transnationals. Distance defines the parameters of bargaining. Certain issues which would naturally become part of the agenda if the state was directly involved remain uncontested.

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[101] See also Tsurumi, "Japanese Investments," 300-308.

[102] In the mid-1970s about 80 percent of the Japanese transnationals in developing countries were co-owned or minority joint-ventures. UNCTC, Joint Ventures, 51-52.

[103] Tsurumi, "Japanese Investments," 306.

[104] Asian Finance, 15 September 1981, 101-104; see also Sanjaya Lall, "Multinationals from India," 44-45.

Since the state is one step removed from reaping the benefits of its bargains, it also stays one step removed from intervening directly in the internal operations of the foreign joint venture. It is this factor that keeps the issue of equity control off the bargaining agenda. The state stops short of directing the process of capital accumulation within the enterprise. "Legal restrictions, fiscal incentives, and bureaucratic regulations are all external. When these are employed bargaining will be over the content of controls rather than over the issue of control itself."[105] And if these external controls do not generate changes in the fundamental issue of control, they can be quite meaningless. The questions of control within the subsidiary are different from those that take place on the external level.

Equity distribution is the determining factor in the power exercised by the domestic partners of foreign firms. Even the state-owned companies had been left to fend for themselves in their joint ventures with their foreign partners. GKBI's bargaining power with respect to its Japanese partners had been much greater than P.T. Sandang I, as the division of equity indicated.[106] The structural position of the two parties and the final outcome in the negotiations regarding the initial equity division had depended on the bargaining power of the two parties. All foreign firms entered into joint ventures with Indonesian partners. The willingness of transnationals to enter into joint ventures with local partners in developing countries varies considerably. Differences exist according to the international structure of their industry and product markets, their global strategy, their past experience, and to some extent, their national origin. The ownership pattern of Japanese, Indian and Hong Kong transnationals in developing countries as joint ventures, as opposed to 100 percent-owned affiliates, can be partially explained by the products they produce. Joint ventures predominated in industries such as textiles, garments, footwear, consumer electronics, and intermediates:

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[105] Peter Evans, Dependent Development, 196.

[106] The state-owned company, P.T. Sandang I had a 30 percent equity share in KTSM, whereas the cooperative, GKBI, had a 47.5 percent share in Primatexco. Corporate

> To generalise, transnationals that manufacture standardised products, diversify product lines, and engage in vertical integration are often willing to enter into joint ventures arrangements. Joint ventures enable these transnationals to obtain from local partners sources of raw materials and intermediaries, as well as expertise on marketing and political, economic and cultural conditions. On the other hand, transnational corporations in high technology industries, those involving intensive marketing efforts or engaged in global and regional integration of production tend to avoid joint-venture arrangements.[107]

Under perfect market conditions there would be little reason for foreign firms to establish joint ventures if their host country partners lack the financial, technological, production and/or marketing resources. In such cases, market imperfections drive the formation of joint ventures. Sometimes these imperfections include the barriers to entry that host governments erect and are often the product of economic nationalism.

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executive, Japanese/Indonesian joint venture, interview by author, Bandung, 17 July 1987.

[107] UNCTC, Joint Ventures, 48.

Moran has described joint ventures as risk-reducing instruments enabling transnationals to neutralise economic nationalism. But joint ventures are not necessarily a response to economic nationalist host government pressures. They can be the manifestation of another facet of the transnational learning curve where the firm takes Hymer's counsel to its logical conclusion. Hymer had argued that to be able to exact oligopolistic rents, firms investing abroad would require some compensating advantage over local firms which had superior knowledge of local market conditions. Therefore, if transnationals establish minority joint ventures with local firms they can achieve the best of all worlds. The transnationals combine their internalised advantages with those of the local firm; they prevent the local firms which are now allies from becoming their rivals; and within the joint venture the transnationals' majority share enables them to control all strategic decision-making. In the 1967-1973 period economic nationalist market imperfections did not drive foreign investors to establish joint ventures. Firms from Japan, India, and Hong Kong sought joint ventures to strengthen their position in the local market.

Whether transnationals select real or dummy partners reflects willingness to share control and the role that they expect their partners to perform. In many industrialising countries this choice has produced two kinds of partners, two kinds of sole agents: the rentier and the entrepreneur.[108] It is one of the risk-reducing counter-strategies that transnationals use to overcome or preempt entry barriers in developing countries without relinquishing control over their subsidiaries.[109]

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[108] For instance see Nora Hamilton, "Mexico: The Limits of State Autonomy," Latin American Perspectives, 11, no.2 (Summer 1975), 100-101; Evans, Dependent Development.

Definitions of a suitable partner abound, depending upon the foreign partner's objectives. The rentier is selected purely as a political resource. Foreign firms in Indonesia often include a "front-person" to perform public relations functions. Transnationals consider these local partners as assets in making bolder representations to government officials and because they understand the social and political environment, which translates into considerable "political" risk reduction for the foreign firm.[110] For an Indian executive, a "dummy" partner, not one who would be involved in decision-making, was a genuine partner.[111] In Indonesia, this role is traditionally played by a pribumi Indonesian.

But some companies also seek links with the developing country's nascent entrepreneurs to capitalise on their marketing experience. They want "real" but subordinate partners. While also appointing a dummy partner, the Japanese sogo shosha and Hong Kong firms chose successful Chinese traders/and or manufacturers and state-owned industrial enterprises who were their previous clients and with whom they had established trustworthy business relationships before 1967. Firms from Hong Kong were naturally inclined to establish relations with their Indonesian Chinese blood relatives. In this relationship the transnationals derive their "compensating advantages" from technology and finance. To retain their bargaining advantage, transnationals must have knowledge that applies to the industrialising country and that local entrepreneurs cannot access on the open market.[112]

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[109] For a good discussion of the corporate learning curve which aims to neutralise the advantages that host governments derive from climbing the host government learning curve see Theodore H. Moran, "International Political Risk Assessment, Corporate Planning and Strategies to Offset Political Risk," in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. T.H. Moran, Chapter 5. For a good discussion of the reasons why transnationals sign joint ventures with host country firms, see Jack N. Behrman, J.J. Boddewyn, and Askok Kapoor, International Business-Government Communications (Lexington, Mass: D.C. Heath and Company, Lexington Books, 1975), 109.

[110] Evans, Dependent Development, 203.

[111] Corporate executive, Indian transnational, interview by author, Jakarta, 13 July 1987.

The local partner usually contributed existing plant and warehousing facilities which could be upgraded. The local partner could arrange government clearances with respect to the modernisation of the plant, hiring and training of local workers and personnel, and its sales force and distribution system could serve as the nucleus for greater marketing effort.[113] By engaging in these joint ventures, transnationals shared the start-up risks, obtained domestic marketing management and knowledge of local customs and political situations, a common practice in industrialising countries. The local entrepreneurs willingly accepted minority positions in foreign joint ventures because they wished to gain the financial and technical expertise from the foreign partners. In return, these partners taught their foreign partners the local marketing tricks of the trade.

Section III

The overall visibility of transnationals has a significant impact on the manner in which they are viewed by nationalist groups in the host country. Local interests tend to question the merits of foreign investment when it appears to bring scant benefits to the local economy. Two factors that produce fears of foreign dominance among economic nationalists are the national origin of foreign capital and its pervasiveness in the host economy.

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[112] Evans, Dependent Development, 203.
[113] UNCTC, Joint Ventures, esp. 66.

In a manufacturing industry such as textiles, economic nationalism does not focus on questions of increased taxation and revenues for the state. It has to do with jobs, with local equity participation in joint ventures, with the impact or at least the perceived impact of foreign capital on the health of the domestic industry. By contrast, in a natural resource industry such as petroleum, these are important but secondary questions. In natural resource industries, economic nationalists are primarily concerned with national control, which ultimately boils down to the question of the division of economic rent.

The 1970s comprised a phase of aggressive public anti-Japanese sentiment in Indonesia which produced restrictive state policy against them in 1974-75 and 1978-1979. In this encounter, with transnationals two kinds of pressures combined to encourage the Indonesian state to adopt a more activist stance towards transnationals. Economic nationalism of the populist variety played a significant role in creating the conditions for a more restrictive environment for foreign investors. No parleys occurred between state and transnational. No formal bargains were struck. This was because the transnationals' vocal opponents were from within the ranks of the intelligentsia, which spoke on behalf of the marginalised petit bourgeoisie, which only marginally participated in the populist debate. The second set of pressures took the form of latent interests. But their existence in the state apparatus and within sections of the dominant fractions of the domestic entrepreneurial class gave them a potent legitimacy. Economic nationalism pertaining to those sectors of the economy that a regime defines and treats as non-strategic areas of activity, produces general and external regulations with regard to the role of foreign capital. It does not produce bargaining encounters as in the oil industry. This is partially because most host states lack the administrative capacity to adopt a case-by-case approach with foreign investors in all sectors. It is through regulatory gate-keeping that the state bargains with transnationals in the so-called "non-strategic" sector. These external regulations do not precipitate radical shifts in host country bargaining power and the all-out confrontations evident in the bargaining encounters between transnationals and the state in strategic sectors, be they natural resource or manufacturing.

It was the alliance among Japanese capital, the state, and powerful Chinese interests that became the subject of outcry. Resentful students who lived in close proximity with the Majaylaya's small-scale weavers and saw their companies torn asunder blamed their unfortunate state on the alliance between Japanese and domestic Chinese investors. It culminated in the August 1973 anti-Chinese Bandung riots and the January 1974 Malari riots that coincided with Japanese P.M. Tanaka's January 14 visit to Indonesia. It was this group, not a powerful group of Chinese domestic producers, who served notice on the government to do something about controlling foreign investors. The continued prominence of pribumi Indonesians as dummy partners was also criticised.

If Japanese capital had only invested in the textile industry or a few sectors of the economy, it would not have produced such fears. But the spectre of Japanese colonialism raised its head frequently in the Indonesian psyche. It was intolerable that after the bitter colonial experience, Japanese consumers squandered a large chunk of Indonesian resources, Japanese consortiums continued to make huge profits from them, while the average Indonesian derived few benefits.

Indian firms that gradually entered the Indonesian market, mainly after 1973, although they often provided a less benign service than their Japanese counterparts, did not produce the same visions of domination and imperialism.[114] History raised no phantoms. And in the Indonesian psyche, India was a developing country that had suffered a similar fate at the hands of the imperial powers and their corporate citizens. And so an alliance was formed between foreign capital from India and "asli" domestic capital. Both were critical of the role of Japanese and Chinese capital. Chinese capital from Hong Kong, Singapore and Taiwan was faulted because of its shared blood ties with Indonesians of Chinese ancestry, both of which were considered foreign and exploitative. Indian capital from Hong Kong and Singapore received a kinder reception. In both cases the role played by capitalists from these countries often took the form of finance capital. These capitalists did not establish production facilities, a task they left to their domestic Chinese or Indian counterparts.[115]

U.S. foreign investors were also seen as kinder, gentler creatures. It was not long ago that in the context of the oil industry, U.S. investors had been portrayed as imperialist exploiters. The perception that Pertamina now had full control over the oil industry, that the government very nearly had obtained a just division of profits, that foreign companies were mere contractors to the state altered the portrayal. Several newspaper articles compared the operating practices of American and Japanese multinationals. Caltex, Stanvac and Citibank were lauded as model corporate citizens, contributing amply to community development while the Japanese were portrayed as blood-sucking leeches.[116]

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[114] Indian investors and developing country transnationals have traditionally paid lower wages and provided less employment benefits to their workers. But even their own managers have not been spared because of the smaller working capital budgets of these firms. For a discussion of Thee Kian Wie, "Indian Direct Investment in Indonesia," ASEAN Business Quarterly 4, no.2 (1980), 33-37. Idem, "The Surge of Asian NIC Investment," Bulletin of Indonesian Economic Studies 27 (December 1991), 55-88.

[115] In Indonesia there is a small but fairly prosperous trading community of Indian origin.

Paradoxically, the backlash against Japanese investors came when they were reducing their worldwide foreign investments. Japan's foreign investment had fallen, hovering around U.S.$ 0.7 billion and U.S.$1.2 billion in 1973.[117] This was the product of the Japanese government's tight monetary policies because of reduced liquidity engendered by rising oil prices. Further, Japan's textile industry had begun its recessionary phase.[118]

Populism forces the state to adopt a more stringent approach to transnationals. The effect of populism on state policy demonstrates that even authoritarian regimes cannot ignore their legitimation functions for long. To achieve and sustain legitimacy, the state must readjust the alliance, if ever so slightly, to cater to new demands requiring resolution within the polity. The state's structure, its objectives and the alliances it forges determine whether state decision-makers treat populism as an enabling instrument in their bargains with transnationals or as a nuisance factor that prevents them from maintaining the status quo in their alliance with them. Vernon remarks that decision-makers are torn between legitimation, which forces them to respond to populist pressures, and accumulation, which forces them to placate foreign capital "in order not to kill the egg-laying goose."[119] But over time host country decision-makers tend to become more restrictive towards foreign investors and reduce the protection available to them.[120]

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[116] See for instance Harian Kami, 27 April 1973.

[117] Japanese Bank Executive, Jakarta, interview by author, Jakarta, 19 February 1987.

[118] Ibid.

Foreign investors react to populism with fear. Consequently, they at least make a public show of conceding to populist demands without much opposition. "The threat of what in the literature of game theory is called "a warfare solution" brings the companies to accept a less favourable share than might otherwise be the case. Populist forces are bound to make a foreign company more reasonable in reacting to government demands."[121]

In 1972-1973 there was a full-fledged discussion of the weak bargaining position that the government had adopted with foreign capital in the post-1967 period. The Suharto regime was being hit at its weakest spot. When in 1965 Suharto staged his coup, there was a widespread, if muffled, perception that the Western powers (and even the CIA) had helped him to overthrow Sukarno. Since Suharto depended upon his alliance with the United States to maintain control over the country, the government had followed a weak-kneed policy towards foreign capital. There was popular resentment that the native Indonesian medium and small-scale industry had not fared well.

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[119] Raymond Vernon, Sovereignty at Bay: The Multinational Spread of U.S. Enterprises (Harmondworth: Penguin Books, 1973, Basic Books, 1971), 194. Vernon does not use the structural marxist terms accumulation and legitimation but they are inherent in his meaning.

[120] Ibid.

[121] Raymond F. Mikesell, "Conflict in Foreign Investor-Host Country Relations: A Preliminary Analysis," in Foreign Investment in The Petroleum and Mineral Resources: Case Studies of Investor-Host Country Relations ed. Raymond F. Mikesell (Baltimore: The John Hopkins University Press, 1971), 39.

As was discussed earlier, several socio-economic factors had weakened native industry. Although its position was not irreversible, it would have required the vision of a leader such as Mao or Nehru and an economic discipline that neither Sukarno's populist regime nor Suharto's bureaucratic-authoritarian military regime could deliver. There was nevertheless strong resentment among the intelligentsia at what appeared to be the neglect of the interests of pribumi medium and small-scale entrepreneurs. There was a widespread feeling that pribumi Indonesians were being overwhelmed by the profits of Chinese and Japanese investors, the needs of Japanese consumers, the close ties between these investors and corrupt government officials, and the liberal economic structure that favoured large investors over smaller ones.[122] This perception culminated in the late 1973 anti-Chinese Bandung riots and the anti-Japanese Malari riots on 15 January 1974.[123] From 1972 until Japanese Prime Minister's Tanaka's visit on 15 January 1974, the press and student activists highlighted these issues.

Press articles criticised the government for failing to treat indigenous capital on an equal footing with foreign capital, for neglecting to regulate foreign capital, and for not requiring Japanese investors to take pribumi partners. "The tendency of the Japanese to get non-indigenous partners gives the impression that Japan wishes to obstruct the proper growth of native businessmen and conspires with the Chinese to keep the Indonesian people in the position of consumers."[124] It was argued that government negligence had brought the small weaving mills of Majalaya to the brink of bankruptcy.[125] In November 1973 students from the Bandung Institute of Textiles carried dramatic placards proclaiming, "A thousand yen are invested and a thousand Majalayas die."[126] There were few signs of the erosion of the entrenched distribution system, controlled by Chinese merchants since colonial times. The American consulting firm, Werner, pessimistically noted, "The power is in the hands of the capitalist class of merchants and wholesalers, basically Chinese, who effectively control the movement of goods."[127] In mid-1972 Merdeka warned that strikes in two textile factories, represented worker opposition to an erosion of the deeply-rooted Indonesian just and prosperous society world-view. The strikes symbolised a refusal to become "milch cows for foreign investors" and party to their "quick profit maximisation schemes."[128]

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[122] See for instance Harian Kami, 22 February 1973. Similar perceptions also prevailed in Thailand. For instance, in January 1973 the Thai National Students Centre organised an anti-Japanese and anti-neo-colonial conference. Merdeka 18 January 1973.

[123] For a discussion of these political changes see Allan Samson, "Indonesia 1973: A Climate of Concern," Asian Survey 14, no.2. (February 1974), 157-165.

In an October 1974 article, the renowned Indonesian nationalist economist, Jusuf Panglaykim noted that the government's requirement that companies provide feasibility reports and 25 percent collateral for state bank investment credits had "prevented many pribumi (indigenous) entrepreneurs from enjoying the facilities."[129] The gap between the economically strong and weak groups had widened because larger non-pribumi firms could obtain investment credits.[130] Resentful Bandung Institute of Technology students noted that the government had encouraged Japanese investors to sign joint ventures with Chinese entrepreneurs by ignoring the applications of small pribumi entrepreneurs.[131] They questioned the basis on which Chinese entrepreneurs had obtained government credits. A delegation of the National Pride Committee, established to investigate government corruption, led by Louis Wangge and Julius Usman, Generation of 1966 student activists, came to Attorney General Ali Said, who was asked to act against government officials who had given billions of dollars in credits to 23 "cukong" businessmen without adequate collateral. Armed with Department of Industry and the Committee for Domestic Capital Investment letters, they asked how the owner of the textile concern Sandratex had obtained credit worth Rp. 5000 million with an initial capital outlay of merely Rp.2.5 million.[132] But instead of being vilipended, by the mid-1980s, Sandratex was destined to become the second largest textile conglomerate in Indonesia.

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[124] Nusantara, 16 February 1973.

[125] Tempo, 30 December 1972.

[126] Mahasiswa Indonesia, 11 November 1973; for the plight of indigenous textile producers see also Harian Kami, 3 January 1974 and Sinar Harapan, 8 August 1973.

[127] Werner, Survey of the Indonesian Textile Industry 2 vols. (Jakarta, January 1972), I, 2.8. In conducting their survey the Werner consultants visited ninety factories and maintained close contacts with government and industry representatives.

[128] Merdeka, 9 May 1972; also see Harian Kami, 11 July 1973 and Merdeka, 26 July 1973.

Merdeka detailed the Japanese synthetic fibre producers' deliberate decision not to establish upstream facilities for basic raw materials' production; the latter were imported from their parents to fulfill their global interests. The energy crisis had raised the costs of these raw materials by 200 percent. "This must be a warning to us, and the Capital Investment Board in particular, that future textile units must be established as integrated units."[133] Harian Kami noted that while the government may have made some efforts to balance the position of foreign investors in Indonesia, Japanese investors had made this impossible. The Japanese companies had prevented their Indonesian partners from investing their equity by increasing their own shares through plant or capital equipment expansions.[134] In response to these criticisms the newspaper Business News, which represented large foreign and domestic firms, commented that the problem was more complicated than just a battle between "wicked foreign capital and innocent national businessmen, who are described as angels, free from any blemish. Without awareness we will be defending low productivity, low technology, and hence low income status [which]...will never create an equal distribution of income".[135] Defending Japan's investors, T.Yoneda, the Japanese embassy's press attache in Indonesia, emphasised that it was Indonesia's internal structural conditions, its governmental structure and the character of its entrepreneurs, that allowed foreign capital to dominate the economy. He held up the example of the success of the Japanese government and business in warding off American capital in the early 1950s.[136]

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[129] "Jusuf Panglaykim, "Financial Institutions in Indonesia," The Indonesian Quarterly 3 no.1 (October 1974), 71.

[130] Ibid.; see also Merdeka, 23 March 1972; Nusantara, 30 March 1972; Pos Indonesia, 28 March 1972; Indonesian Raya, 30 March 1972; Pedoman, 30 March 1972, 16 February 1973, and 13 April 1973.

[131] Pedoman, 12 June 1972.

[132] Merdeka, 15 June 1972.

The government also defended itself. Mohammad Sadli, Chairman of the Capital

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[133] Merdeka, 29 December 1973.

[134] Topik, 1 March 1972.

[135] Bisnis News (Jakarta), quoted in Stephen Grenville, "Survey of Recent Developments," Bulletin of Indonesian Economic Studies, 9 (March 1973), 11.

[136] Topik, 1 March 1972.

Investment Board, expressed satisfaction with the role of foreign investment.[137] Soehead, the Chairman of the Capital Investment Sub-Committee blamed national businessmen for adopting a weak bargaining stance with foreign investors in the initial stages.[138] Barli Halim warned against excessive chauvinism.[139] In his 1972 Independence Day speech, Suharto emphasised that foreign and Chinese capital were indispensable to the industrialisation process. But he also emphasised that the state did not intend to ignore the weaker groups:

> ...the policy measures being prepared were designed to enlarge the ability of the economically weak groups to participate in the process of development...This does not mean that we are to wipe out or kill the role of the economically strong group. It would be very detrimental if we neglect domestic capital, skills, and economic potential only because they belong to a non-indigenous group.[140]

Local capital was not a homogenous entity. Small firms had a different fate from large local firms and rentier capitalists. This division between small and large local capitalists was evident in the functional separation of the bureaucratic agencies established to serve their needs. The BKPM was the agency created to limit as well as advance the interests of foreign and local capitalists. The agency dealt with only a numerically small but dominant segment of firms in the textile industry.[141]

By contrast, the state had created no regulatory agency to limit competition or licensing capacity for small and medium-sized firms. No strong constituency existed to force the government to institute measures to limit their production. These firms had to suffer the harsh three to four-year cyclical booms and busts that characterised the industry. By contrast, their larger counterparts obtained government protection to shield them from market fluctuations through controls over licensed capacity.[142]

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[137] Ibid.

[138] Ibid.

[139] Ibid.

[140] Cited in Grenville, "Survey," 21-22.

[141] Approximately 30 percent of the textile firms came under the direct jurisdiction of the BKPM - those classified as PMDN (large local firms) and PMA (wholly owned foreign firms or joint ventures). Government bureaucrat, interview by author, Jakarta, 6 July 1987.

In 1977 and 1978 similar criticisms against the regime and foreign investment were repeated. The critique was milder in tone compared to the 1973-1974 period but it disturbed the tranquillity of the New Order regime. 1977 had also been election year for the DPR after six long years.[143] And students, who saw themselves as the conscience of the nation, felt obliged to remind the government to rectify the ills festering in the body politic. These ills were primarily encapsulated in the triple alliance among powerful government related elites, Chinese and foreign entrepreneurs that remained entrenched.

The students were joined by the Old Order's right-of-centre leaders who now spoke the language and stole the thunder of yesteryear's leftist politicians. In early October 1977, in a lecture at the Brodjonegoro Student Centre at Kuningan in Jakarta, former Vice-President Hatta emphasised that the state should expand the role of state enterprises and allow them to act as entrepreneurs. But he argued that even more fundamentally, the state must regulate foreign capital, curb capitalist exploitation, break the Chinese dominance over trade, and prevent the unbridled exploitation of the country's forests and other natural resources.[144]

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[142] Government bureaucrat, interview by author, Jakarta, 7 July 1987.

[143] For a discussion of the political background see R. William Liddle, "The New Order's Second Parliamentary Election," Asian Survey 28 no.2 (February 1978), 175-185.

In mid-September 1977 General Nasution lashed out against the technocrats for seeking prosperity before economic justice.[145] Merdeka caustically commented that Japanese investors had done little to dispel Indonesian distrust of their intentions since the ill-fated visit of Prime Minister Tanaka. But Foreign Minister Adam Malik warned students not to disturb the forthcoming visit of Japanese Prime Minister's Takeo Fukuda.[146]

Evans argues that nationalism and political pressure are the most potent instruments to force transnationals to "share control."[147] At various points in their history, a growing number of host governments introduced legislation establishing specified levels of local content, equity participation and the employment of nationals for transnationals operating within their jurisdiction.[148] Bargaining "balance of power" theory expects that over time host governments will become more restrictive as a larger number of domestic groups demand an increased share of benefits from successful projects. But several dynamic dependency scholars express scepticism of such a result in manufacturing industries.

Although Suharto reaffirmed his commitment to maintain the basic alliance structure of 1967, he diluted the alliance with foreign and Chinese capital. Within a week of the Malari riots, Suharto responded with a slew of foreign investment restrictions. In a 22 January 1974 speech, "Fundamentals in Foreign and Domestic Capital Investments," Suharto announced regulatory curbs on foreign and Chinese investors and measures to protect their indigenous partners.[149]

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[144] Kompas, 7 October 1977.

[145] Sinar Harapan, 12 September 1977.

[146] "The Meaning of Premier Fukuda's Visit," Merdeka 12 August 1977.

[147] Evans, Dependent Development, 215.

[148] Robert T. Kudrle, "The Several Faces of the Multinational Corporation: Political Reaction and Policy Response." in An International Political Economy ed. W. Ladd Hollist and F. Lamond Tullis (Boulder: Westview Press, 1985), 183.

Import-substituting foreign firms were to sign joint ventures with pribumi or government firms.[150] Indonesian equity would be increased to 51 percent within ten years. Tax incentives were reduced. The entry of foreign personnel was restricted except where it was scarce or necessary with the expectation that all foreign personnel would be replaced by 1977.[151] If local partners were of Chinese origin then transnationals were to disburse 51 percent of their equity on the stock market within a shorter time frame. Several sectors were closed to foreign capital based on sectoral saturation and the capacity of domestic investors to replace transnationals. Projects would only be classified as domestic investments if 75 percent of the equity was controlled by indigenous investors with foreign management or 50 percent of the equity was controlled by indigenous investors who also managed the operations. Pribumi firms were to be given preferential access to state bank credits. "To promote local capital accumulation and the stock market, the government stipulated that companies with investments of $1 million or more should go public. However, they said that we could maintain 100 percent control."[152]

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[149] Patricia Anne Wallace, "Economic Trends in Indonesia," Review of Indonesian and Malaysian Affairs 9, no.2. (July-December 1975), 36-7.

[150] In the latter arrangment, the government participated as a limited liability company(persoro terbatas) with the government as a shareholder. Ibid.

[151] Hal Hill, Foreign Investment and Industrialisation in Indonesia (Singapore: Oxford University Press, 1988), 31. In 1974 it was estimated that there were around 4,000 foreign workers in the oil sector and 1,000 in textiles. Wallace, "Economic Trends," 37.

In 1975, the Ministry of Industry, Commerce, and Domestic Supplies abolished the old trading system. "It was an attempt to reduce the power of the large syndicates such as Damatex. But as it later became evident this measure was not successful."[153] Little was heard about Suharto's March 1972 acknowledgement of the fears of indigenous business and his empty and rash promise that the government would purchase and redistribute 50-60 percent of non-indigenous shares in private firms to pribumi entrepreneurs.[154]

The state introduced new restrictive policies in 1977 and 1978 to further local capital accumulation. It created an Investment Priority List, Daftar Skala Prioritas, to limit the sectors in which foreign investors could make investments. The decree of the Minister of Trade No.77/KP/III/78 of March 9 1978 prohibited foreign investors and the sogo shosha from trade and the internal distribution of their products.[155] Instead, foreign investors were to create sole agencies to be incorporated as subsidiaries controlled by pribumi Indonesians. The basic aim was to promote capital accumulation among indigenous Indonesians so that they could earn money through marketing if they could not obtain a greater share of profits through equity participation.

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[152] President, Japanese transnational, interview by author, Jakarta, 26 March 1987.

[153] Government textile engineers, Bandung, interviews by author, Bandung, 14 July 1987.

[154] Pedoman, 29 March 1972. Suara Karya, 29 March 1972.

[155] U.S. Embassy, "Indonesia: Investment Climate Statement," 7 December 1985, Jakarta, 12.

Another reward for the domestic business class lay in its greater ability to establish professional lobbies. After 1974 interest groups proliferated. Until then domestic entrepreneurs had been forced to satisfy themselves with KADIN, the corporatist government-controlled business association. Most entrepreneurs did not view it as a genuinely representative association. But the bureaucratic-authoritarian state had severely restricted industry specific associations. In 1968, Ir. Hussein Aminuddin, a large-scale pribumi spinner, failed to secure state recognition for his newly formed Forum Swasta Nasional.[156] In the textile industry a number of associations sprouted after 1974: the Indonesian Garments Association (PIBTI), the Indonesian Synthetic Fibre Maker's Association (APSYFI), the Indonesian Spinners Association (ASPI).[157]

Suharto also issued a number of decrees to protect small-scale capital. Private firms were expected to assist the state in promoting legitimacy for the capitalist system of production, essential to the accumulation interests of the state and of private capital. Large foreign and private firms were to join hands with state enterprises to initiate the foster-parent system, a sub-contracting system, with knitting and weaving firms.

The state cannot ignore the redistributive facets of its legitimation function for too long. The Indonesian state had to make certain concessions to the small-scale sector. A state agency, P.T. Kerta Niaga, was empowered with a monopoly to import cotton yarn and other raw materials for the domestic industry.[158] With the welcome revenue from oil, the government could afford to honour to some extent its promise of easier credit to small-scale entrepreneurs. At the end of fiscal year 1973/1974, 4611 Kredit Investasi Kecil(KIK) applications for Rp 4.0 billion and 3,303 Kredit Modal Kerja Penanaman (KMKP) applications for Rp 2.9 billion were approved. Firms could not import textiles with a merchant's letter of credit. They required a letter of credit from a bank letter of credit where the had to deposit its full value before they could import textiles.[159]

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[156] Harian Kami, 24 December 1968.

[157] President, Japanese transnational, interview by author, Jakarta, 26 March 1987.

[158] See Minister of Trade Decision No. 406/KP/XI/74 dated 11 November 1974 cited in Bank Indonesia Report:1974-1975, 23.

The World Bank discouraged the practice of protecting small and medium-scale textile enterprises,

> ...which are not competitive and protecting them against the products of modern factories is extremely costly, leading to inefficiency, high costs, and inability to export. The modern sector of the industry has hence enjoyed a level of protection equivalent to that needed by the out-of-date small-scale plants and in this shelter uneconomic units have thrived.[160]

But the World Bank's liberal world-view prevented it from envisaging different levels of protection for the small-scale and modern sectors as a solution to the problems bedevilling both sectors. Several strategies had been considered to improve the lot of small-scale factories. Voluntary mergers had been considered but the small private companies had been unwilling to give up their independence.

The state and local capital have a joint interest in maintaining stability and creating legitimacy for the capitalist system of accumulation and production. Therefore, both groups have an interest in promoting some changes that give the public impression that transnationals and state agencies are making contributions to redistribute the benefits of capital accumulation. Officials in the Department of Industry, with the support of representatives of the Japanese joint ventures, began to vigorously promote the Japanese system of sub-contracting work to smaller firms. Presented as a benevolent system, the larger firms would guide the smaller firms to a higher development path. This task was assigned primarily to state enterprises but private firms would assist them with it. Musa, the pribumi spokesperson for the Argo Manunnggal conglomerate, affirmed this view in his inaugural speech as Chairperson of the Indonesian Textile Club, formed as an informal meeting ground for Japanese foreign investors. Musa announced that the large integrated companies intended to provide technical and financial assistance to small-scale investors.[161]

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[159] Minister of Trade Decision No. 407/KP/XI/74, 11 November 1974 cited in Bank of Indonesia Report:1974/1975, 23; see also Decision of the Board of Directors of Bank Indonesia, No.7/107/Kep/Dir/ULN, 11 November 1974.

[160] Confidential World Bank Report to the Government of Indonesia, 1978, 72.

But the new government policies and the new initiatives of private firms did not end the problems of the small- and medium-sized enterprises. Many of them remained tied to the distribution network controlled by merchants. A Unido knitting expert noted that the small-scale weavers lacked skilled managerial personnel, were unaware of consumer preferences, and did poor or no book-keeping. Credit for working capital was difficult to obtain. In 1979, through government neglect, small-scale producers had received a mere 1% of their credit from government loans. The Unido project manager, Mr. Rajaram, noted that one producer who had applied for a loan had not received word about its status from government officials for over twelve months. This had discouraged other firms from applying for assistance. And imitation perpetuated a situation of cut-throat competition among the smaller firms.[162]

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[161] Harian Kami, 10 April 1973; also Alif Martadi, textile consultant, interview by author, Jakarta, 6 January 1987.

The relative power of the social groups vying for changes in policy to suit their interests has a significant effect on the extent to which they will be effective in shaping state policy. Without an independent power base, the middle-class intelligentsia did not constitute a real threat to the military. They lacked alliances with workers and peasants. They could not expect the urban middle classes, significant beneficiaries of the New Order regime's policies, to support a demand for reformist redistributive policies.[163] The rewards for the intelligentsia came in the form of a crackdown. Forty-five student leaders and long-time critics were arrested. Beginning in 1974, the New Order regime established the institutional structure to curb dissent through state-created and state-recognised cooptation, corporatist structures and repressive instruments that became ruthlessly efficient by the 1980s.[164] Of course, the students were the children of the urban middle class and many of them would be future beneficiaries of the system as professional corporate managers, government bureaucrats, joint-venture partners or sole agents.

Local groups that have strong links with transnationals maintain an ideological commitment to economic nationalism since they are often the main beneficiaries of policies that emerge from economic nationalism and it strengthens their bargaining position with transnationals.[165] Consequently, local firms allied with transnationals, most of whom were minority partners with them, did not protest the new restrictiveness of government policy. For Chinese and pribumi partners in foreign joint ventures and for existing or potential wholly-owned domestic firms, the new policies signalled the path for greater capital accumulation and a greater share of future economic benefits.

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[162] M.N. Holmes, Textile Factory Management Development Programme: Project Findings and Recommendations, Terminal Report, No.107, UNDP/UNIDO Project (INS/74/018), 80-81.

[163] Richard Robison, Indonesia: Rise of Capital (North Sydney, Australia: Allen & Unwin, 1986), 165.

[164] Ibid.

Typically, the joint venture took the form of a partnership between senior military officers and Chinese entrepreneurs.[166] As I demonstrated in Chapter 7, Ibnu Sutowo represented a prime illustration of such a beneficiary. His young indigenous proteges, many of whom were collected in the Young Businessmen's Association of Indonesia (HIMPI), favoured a policy of industrial deepening through protection and state intervention. Chinese entrepreneurs who were involved in the alliance would also benefit from the populist attacks on foreign investment even though they did not and could not participate in attacks that were also directed against them. These groups did not launch a public attack on the transnationals. There were entrenched interests within the alliance that had a vested interest in its readjustment. In this particular instance, the transnationals' domestic partners could derive the benefits that came from economic nationalism without threatening or undermining their alliance with foreign investors. There would be no frictions within the alliance because the attack came from political forces that were not formally linked to any of the alliance fractions.

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[165] Evans, Dependent Development, 215.

[166] Harold Crouch, The Army and Politics in Indonesia (Ithaca and London: Cornell University Press, 1978), 287.

The state itself utilised the populist debate to coincide with entrenched but dormant and changing orientations in the state apparatus. The military leadership did not clamp down on the growing anti-foreign momentum when it began in 1972 because there were groups within the alliance that would benefit from populism. In 1973 government officials were no longer heard to be defending their original liberal stance towards foreign investors. As I demonstrated in Chapter 4, there was an entrenched economic nationalist world-view among military leaders whose views were given an intellectual basis by academics in the CSIS. Although the military leadership had chosen not to bargain with the transnationals in the initial stages because of a perception of weakness, it did not abandon its economic nationalist goals.

But this was not all. A little-understood element of Indonesian politics was the changing beliefs of the technocrats themselves.[167] As I demonstrated in Chapter 6, the technocrats had changed their views about the effects of and the benefits from foreign investment since 1973. They no longer saw foreign investors as benign organisations whose activities would automatically bring benefits to the local economy. In effect, they now rejected the neo-classical "trickle down" perspective of transnationals. And they, like Andre Gunder Frank, lamented that they had not adopted a strong regulatory stance towards foreign investors in the initial stages. Unlike Frank's prognostications, they did not remain comprador. Instead, they supported Suharto's moves to tilt the balance in favour of domestic firms.

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[167] Robison describes these changed perceptions as contradictions. Other scholars, perhaps because the insight most clearly emerges from a careful analysis of oil policy making, do not see them.

Thus, there were forces in the state apparatus or groups in civil society that were closely linked to military bureaucrats who had an interest in tilting the bargain in favour of local entrenched interests. For the consumption of its foreign allies, the Malari riots provided the regime with a justification to readjust the alliance while it could portray itself as a state making policy with its hands tied by an unreasonable and irascible populist civil society. Simultaneously, it demonstrated its commitment to the alliance and to maintaining a secure investment climate by re-asserting its control over civil society through repression.

The capitalist state cannot be consistently nationalist. "Not only would this put it into conflict with foreign capital that controls a growing share of the dynamic sectors of the economy, it would also put the state in conflict with the best organised, most powerful local industrial groups who have alliances with the transnationals."[168] The rational capitalist state will not make policy that undermines or threatens to undermine its capitalist base. The state in dependency cannot afford to utilise economic nationalism to maximise the benefits for the local economy at the cost of doing without the transnationals' services. Restrictiveness occurs within those parameters. The Indonesian state could draw transnationals into promoting the nationalist agenda but it could not undermine the basic alliance structure under which capitalist accumulation was achieved.

> "...political and social elites, when undertaking the tasks of adjustment, will try to guide the manner and to limit the extent to which socio-organisational changes required to upgrade the economy occur, so that policy measures designed to increase the rate of accumulation will not

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[168] Evans, Dependent Development, 214.

upset the internal distribution of power."[169]

What effects did the new stipulations have for transnational corporations? The state had enacted legislation that matched the analysis of scholars such as Bennette and Sharpe and Newfarmer, that the state can and does restrict the entry of foreign investors upon entry. In the non-strategic sectors of the economy, it is as gatekeeper and regulator that the state negotiates with the transnationals. It is through performance requirements, rules and regulations, and bureaucratic intervention that the state restricts the entry of new investors. It can restrict the entry of new investors. But what is it to do with old, incumbent investors? Their key bargaining resource, that gives them their elusive character in the case of manufacturing industries, whether based on dynamic and complex or simple and standardised technology, is their ability to leave. Alliances with local capitalists do not prevent this. This is why host governments cannot force them to accept terms that it created after their arrival easily. But this situation only lasts as long as the cost of doing without the services of the foreign investor are high.

The restrictive sectoral limitation applied to new investors, not to incumbent investors. Indeed, the restrictive stipulations benefitted incumbent investors because non-tariff barriers were tightened for domestic and foreign investors. The equity ownership stipulations restricted foreign investors in the long-term but their immediate operations were not threatened. Since it was an economically unreachable goal in the immediate future, the equity stipulation did not threaten capital accumulation in the short-term.

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[169] John Kurt Jacobson, "Peripheral 'Postindustrialisation': Ideology, High Technology, and Dependent Development," in A Changing International Division of Labor, ed. James A. Caporaso, (Boulder: Lynne Rienner Publishers, 1987), 92-3.

The potential beneficiaries of the 51 percent stipulation were incumbent or potential joint-venture partners. Many of these partners were Chinese entrepreneurs or entrepreneurs closely connected to the military bureaucracy. This was the paradox. Robison notes, "Ironically, it was not the indigenous petty bourgeoisie who benefitted most from the new changes but the large domestic capitalists and state-owned capital which moved into a much stronger position with respect to transnational capital. Disaffection among excluded sections of civil society had sought to change this. But while the state clamped down on them, the rewards went mostly to those groups in society who did not come out strongly in favour of changing the balance." [170]

Conclusion

In this chapter I have first shown how the historical antecedents of the domestic textile industry in Indonesia were rooted in past history. Internal structural constraints have a significant impact on the transnational/state/domestic entrepreneur relationship. All is not externally conditioned. Internal constraints are often the product, wholly or partially of past external constraints. In chapter 2 I discussed Indonesia's past encounter with merchant capital. Section I of this chapter demonstrated how the dominance of merchant capital thwarted a movement towards import-substitution industrialisation in the post-independence period.

This past history, that is of internal structural factors, not of the international structure of the industry, made foreign investment essential to the import-substitution industrialisation process. This necessity created a perception of weakness within the state apparatus so that in the first encounter between the Indonesian state and foreign investors from 1967 to 1973, there was no conflict. The state made no attempt to bargain with foreign investors or to impose entry conditions on them.

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[170] Robison, Rise of Capital, 165.

The government had withdrawn from the bargaining battle-field. Or viewed from another perspective, the areas of convergence between transnationals and the government did not produce conflict. Instead, as Bennette and Sharpe would argue, there was consensual bargaining. In the second episode the government did not begin to bargain with foreign investors on its own initiative or at the insistence of powerful entrenched domestic forces. But entrenched and changing orientations within the state apparatus created a strong impetus for restrictive policies aimed at producing a domestic entrepreneurial class.

Chapter - 11

From Strength to Strength

This chapter begins with a discussion of a major development in Indonesian textile history: by the mid-1980s a strong domestic textile capitalist class had emerged. Through joint ventures this class was closely allied with transnational capital. But this chapter also demonstrates that an interaction with transnational capital did not produce denationalisation. In three stages, the rest of the chapter demonstrates how the emergence of an entrepreneurial class combined with a dirigiste state policy created the conditions for reduced protection for the textile transnationals. The discussion focuses on the erosion of the polyester fibre producers' firm-specific assets with brief references to reduced protection for other import-substituting textile transnationals. In the first stage, from 1978-79 to 1983, the state began to pursue an active policy of deepened import-substitution industrialisation. As a consequence, it began to invite rival domestic and foreign firms to invest in areas that had thus far been the preserve of the incumbent transnationals. The second stage, 1983 to 1986, reflects the conflict within the state apparatus and within the capitalist class during a moment of transition: whether the state should dismantle the sheltered structure for entrenched import-substituting firms in the interests of export-oriented firms. The last phase, 1985 to 1988, shows how two fractions of allied domestic and foreign capital are ranged against each other, how they capture specific sections of the state apparatus culminating in the eventual erosion of the polyester fibre-producing textile transnationals' firm-specific assets as the state's orientations change over time. A conclusion is that transnationals that derive their oligopolistic rents from state protection prefer to divest when it is withdrawn.

Section I

Local capital is not a homogeneous entity. As it became clear in the last chapter, large and small local capitalists do not share similar fates and interests. Local capital that has attained the size and finesse to become part of the "international bourgeoisie" must be differentiated from smaller local capital.[1] As Peter Evans suggests, in the textile industry it is not possible to talk of denationalisation.[2]

> If denationalisation were the central thrust of the relations between foreign and local capital, then the supposed alliance between them would be simply a facade to gloss over the growing domination of the foreigners. If the evolution of industrial structure could be summarised in terms of denationalisation, then Cardoso's image of dependent development as entailing the simultaneous and differentiated expansion of different kinds of capital would not apply.[3]

While foreign firms may become prominent, domestic firms do not languish.[4] In the textile industry technology is less important. New technology largely consists of new machines. The transnationals' competitive position is surmountable. Local firms endure because the industry is characterised by low capital and technical intensity. But endurance is often difficult. "Local firms must still compete with each other and with the multinationals for a market. According to the traditional lore of the industry, textiles fluctuate in an exaggerated way relative to the general business cycle."[5]

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[1] Peter Evans, Dependent Development: The Alliance of Multinational, State, And Local Capital (Princeton: Princeton University Press, 1979), 103.

[2] Ibid., 131.

[3] Ibid., 103.

[4] For a good discussion see ibid., 133-143.

In Indonesia foreign investment did not involve denationalisation. About two-thirds of the domestic investments in the late 1960s and early 1970s had been in the textile industry which shows that the textile industry, because of its high labour and low capital intensity, always has room for newcomers.[6] At the end of fiscal year 1973/1974 the weaving and spinning sectors had experienced a capacity expansion of 79 percent and 51.9 percent, respectively. The industry had overcome the imbalances between weaving and finishing in the Second Five Year Plan. Weaving was still the domain of the small-scale enterprises.[7]

From 1969 to 1987 the strategy of import-substitution had successfully produced a large domestic entrepreneurial class with the aid of foreign investors. They had made the transition from commerce to manufacturing. But unlike Evans' description of Brazilian local capital, Indonesian merchants had required Japanese capital to force them out of commerce and into industry. This factor also negates the conclusion that foreign investment has a denationalising effect. Indigenous entrepreneurs dominated the spinning, weaving, and garment industries. In the large-scale spinning and weaving sector, 60 percent of the market was controlled by indigenous Chinese entrepreneurs, majority-owned Japanese joint ventures controlled 12 percent of the market; majority-owned Hong Kong and Indian investors owned 4 percent of the ventures; there was only one large scale pribumi spinning company; the remaining were state enterprises.[8] This reflected the successful implementation of an import-substitution industrialisation drive in creating a class of domestic textile producers. There were no 100 percent foreign-owned ventures although as I discussed earlier, foreigners enjoyed majority equity in them. In joint ventures, foreign investors dominated the upstream synthetic fibre and yarn, producing industry. Cotton fibre came from the international market since domestic cotton production fulfilled only 5 percent of the industry's requirements.[9]

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[5] Ibid., 138.

[6] P.T. Data Consult, "Study of the Indonesian Textile Market," Business Report for P.T. Multinational Finance Corporation, Jakarta, 16 October 1981, 10.

[7] Ibid.

In the 1980s three domestic entrepreneurs of Chinese origin bought out their Japanese partners. The Argo Manunnggal group became the first textile conglomerate to buy out its Japanese partner, Kuraray. The Dasatex conglomerate bought out its Hong Kong partner.[10] These firms had achieved the capacity to duplicate the transnationals' functions and they had accumulated enough capital to make the foreign relationship extraneous because of the easy availability of technology, in the form of machines and experts, on the open market.

Out of the competition brought about by the artificial market saturation of the mid-1970s, several domestic textile companies had became integrated textile groups incorporating spinning, weaving and/or knitting, and finishing. Some conglomerates had moved into export-oriented manufacturing. Of these, the most famous were Daya Manunnggal, Yanota, Grandtex, Famatex, Texmaco, Tarumatex, Panintex, Dasatex, and the Batik Keris.[11]

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[8] President, Japanese transnational, interview by author, Jakarta, 22 December 1986.

[9] Data Consult, "Market for Textiles," 5. In fiscal year 1986/1987 Indonesia imported 171,380 tons of cotton fiber or 95 percent of its total fiber consumption of 179, 930 tons.

[10] Ibid.

In the large-scale integrated sector greater concentration was achieved through the cross-cutting ownership linkages between some foreign and domestically-owned firms. The best-known example is the Argo Manunnggal group in which The Nien King, the fifth richest Chinese in Indonesia in 1987 and Musa feature regularly as shareholders. This group owns several companies including Daya Manunnggal, Yamatex, Grandtex, Gaya Persaki.[12] In 1988 this group stood eleventh on Indonesia's list of largest conglomerates with a sales revenue of $461 million.[13] Concentration increased as the large textile conglomerates began to buy out their foreign partners.

Horizontal integration and diversification enabled the large Indonesian conglomerates to withstand the textile industry's cyclical nature so that they could weather the stormy spells and wait for calmer times. They had interests in banking, insurance, construction, real estate, transportation and logging. Accumulation for Indonesia's conglomerates did not necessarily begin in the textile industry. During the first two five-year plans several firms involved in services such as banks, insurance, car assembling, real estate and trading moved into the textile industry.[14] Liem Sioe Liong(Soedono Salim) headed the Salim group. This was Indonesia's number one conglomerate, with relatively marginal interests in the textile industry including the as yet dormant Tuntex/Sandang polyester fibre company, with a sales turnover of US$4.5

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[11] Data Consult, "Market for Textiles," 9.

[12] Ibid.

[13] Adam Schwarz, "Call for Constraints," Far Eastern Economic Review, 28 December 1989, 55.

[14] Indonesian Commercial Newsletter, 17 July 1978.

billion in 1988.[15] The majority of conglomerates were not listed on Jakarta's still unpopular stock exchange for then they would have to disclose their financial statements. Companies raised funds through their own banks, unaffiliated private commercial banks, state commercial and foreign banks and through joint ventures with foreign investors.[16]

How did many of these conglomerates begin capital accumulation? In the early years the Argo Manunnggal group established links with three Japanese firms. Dasatex, one of the larger Indonesian integrated textile groups, shifted into spinning in 1970 with a capacity of 5,000 spindles. It had 60,000 spindles by 1981. "We did this by buying up small companies that were going bankrupt and refurbishing their machinery."[17] In addition, it had links with a Hong Kong firm. One Chinese entrepreneur explained how Indonesia's textile traders moved into manufacturing:

> Before 1970 we were all merchants - buying and selling yarn and fabric. In 1970 the government introduced the tax holiday. We paid no taxes, equipment was duty-free, and we enjoyed the same incentives as foreign investors. We had accumulated some capital as traders. Some of us obtained capital from our overseas Chinese contacts and second-hand equipment from Hong Kong. The government did not investigate our capital sources. We have never looked back. Since 1970 the domestic private sector has grown five-fold.[18]

The strategies that a state pursues towards transnationals at particular historical junctures are determined by a variety of ingredients. The extent of capital accumulation in the host country has a determining effect on the path of capitalist development. When local capital accumulation has occurred and when domestic entrepreneurs can duplicate the transnationals' functions, the state is in a stronger position to dictate terms. But it is also constrained to dictate those terms to foreign investors. It is forced to give preference to local entrepreneurs and must change the original terms under which foreign capitalists operate. The state must re-adjust the alliance structure and respond to the changing balance of class configurations. It remains constrained by its role as promoter of capital accumulation and to that extent when it bargains with transnationals it does so in response to domestic constraints on its autonomy. It is forced to change the regulatory framework for transnational operations.

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[15] Schwarz, "Call for Constraints," 55.

[16] Yuri Sato, "Business Groups in Indonesia," Pt. 3, The Indonesian Observor, 8 June 1988.

[17] Corporate executive, local Chinese textile firm, interview by author, Jakarta, 16 March 1987.

[18] Ibid.

Section II

As the discussion in Chapter 7 demonstrated, by the latter half of the 1970s, powerful administrative agencies within the state apparatus were seeking to change the direction of industrial development. Within the state agencies, as I discussed in Chapter 7, there were strong entrenched interests that favoured a deepening of the import-substitution industrialisation process with maximum local content. The policy aims of the Third Five-Year required a hard-nosed policy towards foreign investors. In this stage, the impetus for a change in orientations towards oligopolistic foreign investors came from within the state apparatus itself. It was the product of general policies to be adopted towards the manufacturing and petroleum industries rather than a deliberate policy strategy to obstruct the oligopolistic structure of the upstream Japanese textile transnationals. Beginning in 1978-1979, decision makers in the BKPM, the Ministry for the Promotion of Domestic Products, the Ministry of Industry, and the Ministry of Trade pursued several strategies that would partially undermine the oligopolistic, secure and protected environment for the polyester fibre producing transnationals and other textile transnationals.

Textile policy was shaped through regular consultations among three major agencies - the BKPM, the Ministry of Trade, and the Ministry of Industry. Within the Ministry of Industry two agencies were responsible for shaping textile policy - the Directorate of Textiles in the Directorate General of Multifarious Industries and the Directorate General of Chemicals. Textile policy for the stages of the industry ranging from spinning to garment production were the forte of the Directorate of Textiles; the Directorate General for Chemicals dealt with polyester fibre production.

The industry interacted with these agencies in concert and on an individual basis. Industry/government consultations produced policy consensus on levels of tariff protection, supply and demand scenarios, and levels of competition in each segment of the industry. It was on the basis of these interactions that the state, through joint-consultation between the Ministry of Industry and the BKPM, also produced the Daftar Scala Prioritas(DSP) which became a powerful state instrument to limit competition by controlling the entry of new firms into an industry and to keep supply and demand in balance. The DSP was the instrument that established when an industry segment had become saturated, when a sector should be closed to foreign investors because domestic investors could replace them, and when to allow new entrants, domestic or foreign, to enter the fray. The BKPM's prime role, a role that it performed for other non-oil industries as well, was to implement the DSP. The BKPM was all-powerful as a regulator of the levels of acceptable overall production capacity within Indonesia's confines. It had the power to limit the level of competition in each sector.[19] But it also had to power to expand it.

Pelita III gave priority to foreign investors who would create backward linkages by processing natural resources into raw materials and finished products, develop basic industries outside Java, and expand the development of non-oil and gas exports.[20] A Ministry of Industry policy paper noted:"...except for industries which already exist at the initial stage of the production process, the developing industrial branches appear to have more linkage with the industries abroad and are less rooted in the Indonesian economy."[21] The policy paper emphasised that this linkage had to be reversed.[22]

The state became more restrictive and introduced performance requirements. This is to be expected, according to the bargaining balance of power/dynamic dependency perspectives. Host states use performance requirements as significant bargaining resources. In 1981 the Indonesian state barred foreign investors from investing in polyester staple fibre, spinning, weaving, and knitting ventures. Special incentives were only available to foreign investors who were willing to establish backward linkages for polyester-chip production and the raw materials to produce them.[23]

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[19] See also Thee Kian Wie and Kunio Yoshihara, "Foreign and Domestic Capital In Indonesia," Unpublished paper, 12 July 1986, 12.

[20] Ministry of Industry of the Republic of Indonesia, "Development Program for Basic and Key Industries and Some Ideas on Industrial Development in the Fourth Pelita," Jakarta, August 1982, 1.

[21] Ibid., 4.

[22] Ibid., 8.

[23] Ibid.

The role of state-enterprises was expanded where foreign investors refused to venture. The government commissioned the expansion of several state enterprises to strengthen their role as stabilisers for the small-scale domestic industry by providing 40 percent of its cotton yarn requirements.[24] The state encouraged domestic firms to establish wholly-owned ventures in sectors that had hitherto been the preserve of foreign investors.

In the process of implementing the second and fourth of these measures the state began to erode the transnationals' oligopolistic control. Until 1979 the Indonesian state was in a dependency situation with respect to the polyester staple fibre (PSF) producers. It lacked the administrative structure to monitor prices. Tariffs were implemented on the basis of information provided to the Ministry of Trade by the industry. The oligopolistic structure that the PSF producers were able to maintain reflected the nature of a typically dependent state that is held hostage by transnationals and does not create the necessary institutional structure to control their activities. How had the transnationals come to establish this oligopolistic structure in the Indonesian textile industry?

The environment in which firms operate is not perfectly competitive. Firms are not driven by efficiency and/or welfare creating motivations but by profits. Efficiency and/or welfare creation may be the means to the profit-making goal but they are not ends in and of themselves. Firms will seek efficiency if it serves their profit-making goals;

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[24] The Ministry of Industry noted, "At the present stage ...the government only supplies 18 percent and it is ...difficult for Sandang I and Sandang II to act as stabilising agents." Ibid., 20. These projects included the expansion of the following spinning mills: P.T. Industri Sandang I in West Java, P.T. Sandang II in East Java, P.T. Primisima in Yogyakarta in Central Java. Ibid., 24.

otherwise not. Firms seek protection when it serves their advantage; otherwise they seek free trade. This is true of firms in industrialised and industrialising countries. It is not a feature of the less industrialising country per se.[25] As Newfarmer argues, "foreign investment is strongly and persistently linked to domestic oligopoly in the host country and that domestic oligopoly generates high profits for those fortunate enough to operate in these markets."[26] The high profits that firms derive are primarily the product of concentration and other market imperfections.[27]

Inter-capitalist strife has historically been curbed by high entry barriers. Some are firm-specific arising from such factors as economies of scale, finance, technology, and markets. Public policy barriers include "promotional instruments, protective mechanisms, and regulatory regimes."[28] These public policy instruments often shelter local firms from their stronger transnational competitors. But normally they shield national and incumbent transnationals from rivals. These barriers produce high degrees of market concentration.[29] Liberal economists are correct when they argue that foreign direct investment does not necessarily produce efficiency and welfare.[30] But they are wrong when they assume that transnationals are not active creators of market imperfections and just passive respondents to externally generated imperfections, those created by states.[31]

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[25] Gill and Law argue that this is a specific characteristic of less industrialising countries because governments tend to create market imperfections quite assiduously. Stephen Gill and David Law, The Global Political Economy: Perspectives, Problems, and Policies (Baltimore: John Hopkins University Press, 1989), 191.

[26] Richard S. Newfarmer, "Multinationals and Marketplace Magic in the 1980s," in The Multinational Corporation in the 1980s ed. Charles P. Kindleberger and David B. Audretsch (Cambridge: The M.I.T.Press, 1983), 171.

[27] Ibid. See also Gill and Law, Global Political Economy, 191.

[28] Claudio R. Frischtak, "From Monopoly to Rivalry: Policies to Realize the Competitive Potential of Transnational Corporations," Transnational Corporations 1 (August 1992), 59.

[29] Ibid.

[30] Gill and Law, Global Political Economy, 203.

As will be recalled from the previous chapter, tariff and non-tariff bargaining had been pervasive. Foreign investors had frequently secured entry on the condition that barriers to entry be erected to subsequent entrants, either by reducing import competition through tariff barriers or by restricting domestic competitors through the BKPM licensing procedure.[32] The three Japanese-Indonesian polyester fibre firms, P.T. Indonesia Toray Synthetics (ITS), P.T. Kuraray Manunnggal Fiber Indonesia(Kumafibre), and P.T. Teijin Indonesia Fiber Corporation(Tificorp) had persuaded the BKPM to keep other investors from their market niche.[33]

As later entrants to the market, Indian investors had looked for alternative market niches to establish oligopolistic structures. Two Indian companies chose the viscose rayon sector, where there were no foreign or domestic competitors. "The Europeans and the Japanese were not interested in rayon."[34] Bombay Dyeing, which had become renowned for its production of high quality towels and sheeting in India since the 1950s, sought to monopolise the Indonesian domestic market.[35] Until its arrival on the scene, domestically produced towels were of poor quality. And double-width sheets were produced by joining two single-width ones.[36]

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[31] James C.W. Ahiakpor, Multinationals and Economic Development: An Integration of Competing Theories (London and New York: Routledge, 1990), 14-15.

[32] Hal Hill, Foreign Investment and Industrialization in Indonesia (Singapore: Oxford University Press, 1988), 140.

[33] The three Japanese textile manufacturing companies in these joint ventures, Toray, Kuraray, and Teijin were among the fifteen largest synthetic manufacturers in the world. Peat, Marwick and Mitchell & Company, "A Market Survey," in P.T. Tuntex Sandang Fiber Information Memorandum, U.S. $56,000,000 Project Facilities Consisting of US $36,000,000 Supplier Credit Facility Supported by The Export-Import Bank of China(Taiwan) and U.S. $15,000,000 Raw Material Financing Facility, P.T. Asia Limited, Bankers Trust Company, July 1983, 185.

[34] Corporate executive, state-owned company, interview by author, Jakarta, 10 March 1987.

Until the early 1980s the three major Japanese polyester fibre producers benefitted enormously from the government's protectionist policy, which can be summarised as follows:

> The basic policy (of the government) is to protect the (PSF) industry through tariffs and in unusual circumstances with import bans; 2) to allow the producers to pass on their increased payments in rupiah terms payments for raw materials imports, financing charges and principal repayments in the event of major devaluations by allowing the rupiah price of PSF to be increased and iii) to restrict the number of new plants and expansions so that over-capacity in the industry is not excessive at any time.[37]

The domestic market for PSF was composed of large producers and large spinning mills. In 1981 the ten largest spinning mills consumed approximately 49 percent of all locally produced and imported PSF. The Kumafibre group and the Sandang group were the dominant consumers of PSF. Kumafiber alone consumed 17.5 percent of total demand.[38]

Two distribution practices prevailed in the synthetic fibre industry. Integrated companies such as Kumafibre had "highly confidential internal distribution and transfer pricing arrangements within integrated industries owned and managed by the same parties."[39] Approximately 50 percent of the company's raw materials were consumed by the Manunnggal group itself while the remaining production was sold to spinning companies with which it long-term supply arrangements. Other companies such as Tificorp had long-term arm's-length supply arrangements with the large spinning mills with 30,000 or more PC and/or PR spindles.[40] A Teijin executive noted, "We have forty regular customers. ...We have long-term relationships with these customers which include the large spinning and integrated companies such as the Daya Manunnggal group, P.T. Sandang I, Trisulatex."[41]

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[35] Managing-Director, Indian transnational, interview by author, Bandung, 3 August 1987.
[36] Ibid.
[37] Peat, Marwick, and Mitchell, "A Market Survey," 45.
[38] Ibid., 174.

Several factors enabled the Japanese joint ventures to maintain internationally uncompetitive prices. With market concentration and high non-tariff and tariff barriers they could maintain high prices because they had explicit unwritten non-competition agreements about quality control and prices which they would set periodically to avoid inter-firm competition.[42] Their favoured customers were tied into long-term supply arrangements. But even their non-preferred customers favoured domestic supplies for several reasons: long-term supply security; excellent quality; the uneconomic carrying costs for imported products including interest costs on letters of credit and the three-month warehousing costs which reduced the price differential between domestically produced and imported synthetic fibre.[43] An effective tariff of 22.5 percent on imports narrowed the price differential between domestic and imported PSF.[44] Finally, rupiah-financed raw materials requirements reduced their foreign currency liabilities.[45]

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[39] Ibid. Vice President, Indian transnational, interview by author, Bandung, 6 August 1987; Vice President Marketing, Indian transnational, Bandung, 6 August 1987; Senior Vice President, Indian transnational, interview by author, Bandung, 7 August 1987.

[40] Peat, Marwick and Mitchell, "A Market Survey," 174.

[41] Finance Director, Japanese transnational, interview by author, Jakarta, 14 May 1987.

[42] Vice President, Indian transnational, interview by author, Bandung, 6 August 1987; Senior Vice President, Indian transnational, interview by author, Bandung, 7 August 1987.

By 1978 the Indonesian state found the original terms under which foreign investors had entered the country onerous and unfair. It was prepared to undermine the original bargain with foreign investors and to renege on one promise that it had made to early entrants: to prevent the entry of competitors, local and foreign, into their market niche.

Host governments can reduce the oligopolistic control exercised by incumbent transnationals in the domestic market by introducing rivals.[46] It can encourage public and private domestic investors to establish licensing, supply, and equipment contracts with foreign investors from other countries. Where possible host governments encourage wholly-owned domestic ventures. In Indonesia, the BKPM, the all powerful agency with the authority to limit as well as expand levels of competition and concentration, now only seven years after the first polyester staple fibre producer began operations, reduced the protection available to the Japanese PSF transnationals.

From 1981-1987 Indonesia recorded the highest growth rate, 9.5 percent, for synthetic production facilities among industrialising countries.[47] In nylon filament, the two Japanese companies, Indonesia Toray Synthetics and Indonesian Asahi Chemical Industry, were challenged by two new firms. In polyester staple fibre, the wholly-owned domestic firm Tri Rempoa which controlled 25 percent of total installed capacity when it came on-stream in 1983, challenged the "Big Three". By mid-1987, two other domestic firms were scheduled to begin production.

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[43] Senior Vice-President, Indian transnational, interview by author, Bandung, 10 August 1987.

[44] Peat Marwick and Mitchell, "A Market Survey," 191.

[45] Senior Vice President, Indian transnational, interview by author, Bandung, 10 August 1987.

[46] For a more detailed discussion see Chapter 4.

A 1982 market survey approvingly noted that there would be a movement towards workable competition as the industry became vertically de-integrated and more firms entered the market.[48] The existing Japanese conglomerates would be forced to use cheaper domestically produced raw materials and pass on their savings to consuming companies. Finally, the existence of many more players in the domestic market combined with world-wide excess capacity would force firms operating in the Indonesian market to reduce prices.[49]

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[47] UNCTC, Transnationals in Textile, 11. At the end of 1979, 1980, and 1981, 1983 four domestic companies, PT Texmaco Taman Synthetic, PT Susila Indah Fibre Industry (PT Sulindafin) and PT Yasinta respectively commenced production of polyester nylon filament yarn and polyester filament yarn. In 1982, 2 Indian companies, PT Indo Bharat Rayon and PT South Pacific began producing rayon fibre. Indonesian Commercial Newsletter, 15 May 1984, 6. In 1984, seven companies applied for investment licenses to establish synthetic fibre plants in West Java. These companies included P.T. Parahyangan Poy Mill, P.T. South East Synthetic Filament Mill, P.T. Merak Fibre Industry, P.T. Pan Asia Synthetic Abadi, P.T. Central Filament Nusantara, P.T. Invetco Acrylic, and PT Inti Indorayon Utama (Viscose rayon). For the planned capacities of these plants see P.T. Capricorn Indonesia Consult Inc., "A Study on the Market for Textiles in Indonesia," 1986, 24. In 1986 PT Vastex Prima had a licence to establish production facilities for polyester staple fibre. In 1984 the BKPm licensed P.T. Susila Indah Synthetic Fibre Industries to diversify into polyester staple fibre at an annual capacity of 14,000 tons. In 1984, Indonesia had ten synthetic fibre plants already in production with a combined capacity of 176, 950 tons a year. Production increased from 72,981 tons in 1979 to 152,450 tons in 1983. Indonesian Commercial Newsletter, no.252, 27 August 1984, 19. In January 1987, the BKPM approved the establishment of P.T. Central Filament Mills in Bandung, West Java with an investment of Rp. 48.34 billion. The Jakarta Post, 30 January 1987.

[48] Peat, Marwick and Mitchell, "A Market Survey," 179. For a discussion of a movement towards workable competition in some industries see Raymond Vernon, Storm Over the Multinationals: The Real Issues (London: The Macmillan Press, 1977), 81. For a rebuttal, see Richard S. Newfarmer, Transnational Conglomerates and the Economics of Dependent Development: A Case Study of the International Electrical Oligopoly and Brazil's Electrical Industry Contemporary Studies in Economic and Financial Analysis, Vol. 23. (Greenwich, Conn.: Jai Press, 1977), chap.1. For an evaluation, see Rhys Jenkins, Transnational

The state's increased autonomy from the Japanese PSF producers was reflected in the cavalier treatment that it meted out to them: "The applications of these producers to increase production capacity by constructing new lines have all been rejected by the BKPM."[50] In 1987 one Japanese executive commented, "The government is now less willing to give us protection."[51] The BKPM also broke the Bombay Dyeing Group's monopoly by granting licenses to domestic producers Bintang Agung and Lucky Prints.[52] In 1982 we discontinued towel production for the domestic market. We had not expected such a huge domestic demand for cheap knitted towel."[53]

The specialists of bargaining between the state and foreign capital expect such an outcome. The state's bargaining power increases when the value of the transnational's services diminishes in response to changing conditions in the international and domestic environment. Host governments derive increased bargaining power from a variety of

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Corporations and Uneven Development: The Internationalisation of Capital and the Third World (London: Methuen, 1987), chap.3.

[49] Peat Marwick and Mitchell, "A Market Survey," 46, 174.

[50] Ibid., 45; Textile consultant, interview by author, Jakarta, 16 December 1986.

[51] President, Japanese transnational, interview by author, Jakarta, 22 December 1986, 22 December 1986.

[52] Managing Director, Indian transnational, Bandung, 3 August 1987.

[53] Ibid.

sources.[54] Competition and the easy availability of products and services on the open market that the foreign investor had originally provided are two major components that enable host governments and local firms to bargain with incumbent foreign investors from a position of strength. When domestic investors, foreign investors from other countries, and state enterprises can provide the smae service at a competitive price, then the state no longer needs to provide entrenched foreign investors with incentives that they had previously extracted. The state is no longer willing to pay as high supply price to the transnationals to achieve joint/maximisation. Now the onus is on the foreign investor to prove that its firm-specific assets remain unique enough to bring benefits to the host economy that its competitors are unable to provide.

The state can pursue its goals with relative independence from transnationals when its balance of payments position is stronger and when it can ignore the watchful scrutiny of the international financial institutions. Governments can use state enterprises and invite foreign investors from other countries to fulfill objectives that it cannot persuade entrenched foreign investors to perform because they misjudge the extent and duration to which they can hold the host government hostage. The state can utilise competition to drive a harder bargain with incumbent foreign investors.

Alliances with foreign companies bring the state-owned companies directly into the production process. These alliances enable them to enter areas that they would be unable to enter on their own because they lack technical skills or capital. Alliances

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[54] T.H. Moran, "Multinational Corporations and Third World Investment," in Latin America: Dependency or Interdependence ed. Michael Novak and Michael P. Jackson (Washington D.C.: American Enterprise Institute for Public Policy Research, 1985), 16-17.

involving local, foreign, and domestic capital obscure the differences between different segments of capital and leads to closer integration among the various alliance members. It was just such an alliance that the state-owned company P.T. Sandang I signed with the Taiwanese company, Tuntex, which had collaborated with German, not Japanese machinery producers.[55] In the Tuntex agreement, the Japanese companies and sogo shosha were excluded from all stages of the supply and production process.[56] But the venture reflected the continued dominance of the Chinese conglomerates in the economy and their overseas links in Hong Kong and Taiwan. And it was an alliance between foreign Chinese capital, domestic Chinese capital, and the largest state-owned enterprise, Sandang I.

The contractual terms of the Tuntex agreement suggest that the state sought to utilise competition to drive a harder bargain with incumbent investors. It prodded them into accepting that the indigenisation of majority ownership was a legitimate exercise and to accept the erosion of their vertically integrated structure by using domestically produced PTA instead of importing it from their affiliated firms. Tuntex would transfer more than 51 percent of its equity to its Indonesian partners within ten years and it would utilise domestically produced raw materials.

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[55] Indonesian Commercial Newsletter, 15 May 1984, 8-9. The parent company, Tuntex Fibre Company, was the fourth largest polyester manufacturer in Taiwan after Hualon, Nan Ya, and Sin Kong, ranking 69th in terms of sales among the largest companies in Taiwan. Peat Marwick and Mitchell, "A Market Survey," 221.

[56] Letter to P.T. Sandang Industri I from Y.H. Chen President, Tuntex Distinct Corporation (Taiwan), dated November 23 1981. Chen promised not to utilise Japanese raw materials and equipment in the plant and operations.

The state began to erode the PSF producers' vertically integrated turf by creating backward linkages for the production of basic materials for polyester fibre production such as PTA so that alternative raw materials sources were available to consuming companies including state-owned companies. The state aimed to force the existing Japanese companies to utilise domestically produced raw materials rather than to import them through their parent companies. It also sought to create arm's length prices for raw materials to uncover and control the over-invoicing of intra-firm raw materials sales between Japanese parent or sister companies and their Indonesian subsidiaries.

Over-invoicing disconcerts host states for two reasons. First, it raises the costs of the final product to consumers since intermediary companies pass on increased raw materials costs to their consumers. Second, when foreign subsidiaries book higher raw materials costs their net profits are lower. As a consequence, the tax revenues available to the state are also lower. All Japanese companies were consistently showing losses which reduced the total tax revenues that were available to the state.

The Indonesian state could do this because its options had increased. When the host state can obtain access to alternative sources of technology in bundled or unbundled form and when it has the financial resources to develop an industrial linkage on its own, then the host state or local firms do not have to pay transnationals as high a supply price as they could previously extract. The second oil shock gave the Indonesian state ample revenues. To undermine the Japanese PSF producers, in joint ventures with Pertamina, Exxon began to construct an olefine plant and Kellog completed an aromatics plant which Suharto inaugurated in August 1986. In the spring of 1988, the BKPM granted Tommy

Suharto, a license to establish a 30/70 joint venture with Thyssen Rheistahl Technik of West Germany for an aromatic plant in Arun, Aceh with a total investment of US$ 916 million.[57] These projects were intended to fulfill the state's goals of furthering import-substitution industrialisation, achieving self-sufficiency in the textile industry, and promoting a domestic entrepreneurial class.

The interests of foreign investors and the host government differ significantly. While the host state seeks to maximise the advantages to the local economy, the transnational seeks to maximise the global profitability of the firm. Transnational corporations tend to maximise economies of scale by producing specific components in one location and they avoid functional duplication in their subsidiaries. This leads to plant and component specialisation and the spatial division of labour to reduce location costs. They also seek to maximise their profits from their firm-specific advantages - their control over technology and the production of components or raw materials that are not available in the host country. It is not in the interests of transnationals to duplicate the production of those raw materials in the host country, especially if they fear that the host government might eventually take over the operation. Transnationals are also averse to producing basic raw materials in the host country because it might prevent them from enjoying the advantages of transfer pricing. In the Indonesian case, where the Japanese polyester fibre producers would have been expected to establish joint ventures with Pertamina, the state owned-oil company, these fears had an objective basis. As Moran argues, the transnationals utilise vertical integration to reduce their vulnerability to host government economic nationalism. In other, words vertical integration serves as a risk-reducing mechanism.[58]

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[57] The Jakarta Post, 8 April 1988. Also see The Jakarta Post, 25 March 1988.

> The internalisation approach is a crucial part of the explanation of net flows of foreign direct investment. Multinational firms will be financed largely through outflows of foreign direct investment in accordance with the pattern predicted by the pressure for multi-plant operation and the prevailing location costs for the constituent activities. Changes in net flows will be occasioned by shifts in the requirements for multi-plant operation and changing relative location costs, i.e by internalised/externalised activities and their crucial input requirements and costs.[59]

Despite repeated pleas during the early 1970s, reminiscent of Caltex's refusal to build a refinery, the government had been unable to persuade the Japanese textile firms to establish backward linkages. It will be recalled that in December 1973 Merdeka had angrily castigated the BKPM for not forcing the Japanese synthetic producers to establish integrated plants despite an abundance of cheap raw materials and it had morbidly predicted that Indonesia would forever remain dependent upon imports from their parent companies.[60] Now the state was itself venturing into these areas. It was in this light that the government had approved the construction of the Tuntex/P.T. Sandang polyester fibre joint venture and more importantly, Pertamina's two joint ventures for the Aromatic and Olefine Centres.[61]

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[58] T.H. Moran, "International Political Risk Assessment, Corporate Planning, and Strategies to Offset Political Risk," in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. T.H. Moran, (Lexington, Mass.: Lexington Books, D.C. Heath, 1985), 112-115.

[59] Peter J. Buckley, The Multinational Enterprise (Houndmills:Macmillan, 1989), 87-88.

[60] Merdeka, 29 December 1973.

[61] Ministry of Industry, "Development Program," 18. In 1978 the Director General of Chemical Industry had commissioned Mitsui to conduct a feasibility study after the foreign partners had been selected. See Mitsui and Co Ltd., "Feasibility Study Report: Aromatics Project in Indonesia," April 1979, 2.

> ...the dependency on imported raw materials at present cannot be avoided because domestic upstream industries have not yet been developed. With the absence of olefine and aromatic projects, ...the polyester, plastic, and other synthetic fibre industries are very much dependent upon imports. As a result, the polyester, synthetic fibres cannot compete with similar foreign/imported products so that some protection is necessary and export is not easy.[62]

There are two ways to interpret the state's role in establishing backward linkages. First, the state can be seen as playing the handmaid role for the capitalist class since it is a task that transnationals in the industry are unwilling to perform. Indeed, the capitalist state would not take it on if transnationals performed it adequately. In this sense, it reflects the state's powerlessness in bargaining with transnationals because it cannot persuade transnationals to take on tasks that coincide with its objectives. Second, when the state creates backward linkages, it can be seen as reducing its dependence and that of local domestic and foreign consuming companies on the transnationals.

Section III

In Indonesian economic history, the years 1983-1986 marked a transition. What was evident within the state apparatus and in civil society was a conflict between an entrenched orientation and a newly developing one seeking to dismantle the old one. Policy-making was piecemeal since the battle about what was to be done had still to be fought and won in the wider political arena: whether the state would adopt an export-oriented strategy and relegate its import-substitution industrialisation to the background. Policy-making in textile decision-making agencies reflected this conflict. Policy could be described as veering, now to satisfy the polyester fibre producers and then to placate large consuming spinning and integrated spinning/weaving firms.

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[62] Ministry of Industry, "Development Program," 19.

In this instance, the fragmentation within the textile industry becomes evident. It shows that there are divisions within transnational capital and that it cannot be treated as a cohesive category. Foreign investors operating within different segments of the industry have conflicting interests. The state is forced to juggle these interests as it becomes increasingly interventionist. Indeed, conflict within the capitalist class forces the state to become more interventionist. Its role as referee and mediator becomes explicit. The state cannot continue to safeguard the interests of one fraction of the capitalist class at the expense of its other fractions. For in doing so, the state would endanger its own long-term interests in capital accumulation. As a range of foreign and domestic investors with a diversity of interests entered the Indonesian market, it became more difficult for the Indonesian state to satisfy their diverse needs. This increased the conflict.

The market power of specific fractions of the capitalist class determines their ability to achieve their objectives. But it also depends on the extent to which their interests coincide with entrenched orientations within the state apparatus. Until 1983, in Indonesia, the most powerful orientation prevailing in the state decision-making agencies involved with textile policy was that domestic industry had to be protected at the expense of imports. This orientation gave administrative coherence to economic policy-making. As long as this orientation remained entrenched within the state apparatus the import-substituting firms had greater clout in persuading Indonesia's decision-makers to make policy that favoured their interests. But in the period of transition there was evidence of a change in policy towards the consuming firms which sought to import their raw materials. But changes in the international and domestic environment had to occur before the importing firms could show that their interests coincided with the national interest. In other words, changing configurations in the international and domestic environment are essential for a specific section of the capitalist class to achieve its objectives.[63] The same goes for state decision-makers.

With increasing demand for synthetics the government faced pressure from spinning companies to allow them to import their PSF and nylon filament requirements. In Indonesia, production capacity had not kept up with demand. In 1978, demand had risen to 45 percent of total fibre consumption compared to 30 percent in 1969.[64] In 1981 imports peaked at 20.9 percent of total demand.[65] This excess demand coincided with world-wide excess capacity which in 1982 was expected to be 25.3 percent above the 1981 level.[66] Several Indian and Hong Kong investors who were late-comers in the Indonesian market had been left out in the cold for want of secure access to synthetic fibre supplies because of the tight distribution system and inadequate domestic production.[67] They had been particularly hard-hit during the tight market conditions and the accompanying high prices that prevailed in the international and domestic market from 1979-1982.[68]

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[63] Cardoso and Faletto recognise that transnationals are also structurally constrained. F.H. Cardoso and E. Faletto, Dependency and Development in Latin America (Berkeley: University of California Press, 1979), 180.

[64] Indonesian Commercial Newsletter, 10 December 1979, 15.

[65] Ibid.

[66] UNCTC, Transnationals in the Textile Industry, 11.

[67] P.T. Indonesia Toray Synthetics, Tsuguo Ogasawara, Finance Director, Jakarta, 14 May 1987; Ridwan Indranata, Assistant General Manager, Department, P.T. Istem, (Toray joint venture), 26 March 1987.

Responding to the demands of these transnationals and domestic spinning firms, the government had allowed them to import polyester staple fibre duty-free.[69] Then in the over-supplied market of 1982 they had petitioned the government to force the PSF producers to reduce their prices which exceeded the "Taiwan dumping price" by Rp. 300.[70] Although the polyester staple fibre producers reduced prices by Rp 100, even in this glutted market they had kept prices Rp 200 above the Taiwan "dumping price."[71] It had been government-sanctioned high import duties that had enabled the PSF producers to charge exorbitantly high prices in the first place. These companies also had permission from the Ministry of Trade to import the production of their affiliates facing excess capacity which they sold to consuming companies at the high domestic price. They could maintain prices at levels which kept imports marginally less attractive than domestic supplies because they knew that both foreign and domestic companies preferred to obtain their supplies locally.[72]

Ironically, the first real threat to the polyester fibre producers on the import-front came from the approved-importer licensing system, the product of the protective regime of the early 1980s which included import bans and quotas. The intensity of these instruments increased after 1982 when the world recession depressed the prices of traded goods and the government's balance of payments deteriorated. Approved importer-licenses proliferated. "This partly reflected an industrial strategy, backed by public investment financed from the oil boom, designed to push the process of import-substitution 'upstream' towards basic goods such as cement, chemicals, fertilisers, synthetic fibres, and iron and steel."[73] In late 1982 and early 1983 the Trade Ministry passed several decrees that empowered the Ministry of Industry to issue approved-importer licenses and the Trade Ministry to establish formal and zero quotas in consultation with the Ministry of Industry aimed at increasing local content in manufactured products.[74]

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[68] D. Chowdhry, President, P.T. Elegant Textile Industry, interview by author, Bandung, 11 August 1987. for a similar conclusion see Peat, Marwick, & Mitchell, "Market Survey," 198.

[69] Indonesian Commercial Newsletter, 10 December 1979, 7. Managing-Director, P.T. Kewalram, Bandung, 3 August 1987.

[70] Peat, Marwick, & Mitchell, "Market Survey," 199.

[71] Ibid.

[72] Managing-Director, Indian transnational, interview by author, Bandung, 3 August 1987. High-ranking government official, interview by author, Jakarta, 6 May 1987. Government bureaucrat, interview by author, 5 August 1987.

The Ministry of Industry, which generally remained a stronghold for import-substitution industrialisation, issued licenses to domestic and foreign spinning companies to import polyester and fibre. In 1984, 25 companies had access to these licenses. But they were issued selectively and temporarily to cover domestic shortfalls. Hartarto was not averse to the occasional import ban. In mid-1985 when international prices were low the fibre producers had petitioned the Department of Trade and the Directorate General of Chemicals in the Department of Industry for tariff and non-tariff protection and had received a favourable response. Hartarto had even recommended a zero ban on imports until the first quarter of 1986.[75] But the polyester fibre producers still wanted the government to establish a quota system to regulate cheap polyester fibre.[76]

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[73] Confidential World Bank Report, 5 May 1987, 72-74.

[74] Ibid.

[75] High-ranking government official, interview by author, Jakarta, 16 January 1987.

The shift in government policy away from providing the polyester fibre producers protection became evident as the government gradually reduced tariffs and import bans.[77] The Japanese polyester and fibre producers and their Chinese allies became more anxious with the imminent erosion of their firm-specific assets since their parent companies would soon become irrelevant as raw-materials' suppliers. There would be little room for transfer pricing and little justification for the high costs that they had so far charged their consumers.

Even the Japanese government and the Japan External Trade Organization(JETRO), with an explicit mandate to promote Japanese exports, openly supported a liberalised Indonesian economy. In January 1986 Maasaki Horiguchi, the Chief Representative of Japan's EXIM Bank noted, "The Indonesian government had pursued a policy of localisation as a pure objective to promote domestic industry and create additional employment and opportunities. But this was the main cause of the high-cost economy which prevented the export industry from achieving a strong bargaining position in the international market."[78] How could the PSF producers continue to make a case for high tariff and non-tariff barriers?

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[76] Ibid.

[77] Ibid.

[78] Masaaki Horiguchi, "Finance to Indonesia and the Export-Import Bank," unpublished document, EXIM Bank of Japan, Jakarta, January 1986.

Section IV

Jacobson argues that pragmatism is at its height when, in response to economic urgencies, policy-makers are willing to undermine the interests of previously dominant groups in favour of new coalitions with new policy packages. "What remains is to identify conditions that enable or precipitate 'pragmatic' state action and to examine how one is linked to the other."[79] He also identifies the kinds of conditions that produce "pragmatic state" action - high indebtedness, the exhaustion of an industrial phase, or contradictions between the domestic organisation of production and the requirements of the international market.[80]

The capitalist state is not a monolithic entity heeding a constant path. Its structure and character change over time. The orientations within the state are not immutable. They change over time in response to changing conditions in the international and domestic environment and in response to the shifting alliances within the capitalist class. Transnationals seek to persuade state decision-makers to implement policies that promote their interests or at a minimum to refrain from executing policies that undermine their interests.[81] Contradictory policies are likely to emerge within the state apparatus when different conceptions of the so-called general interest become entrenched in different state agencies. As capitalists, domestic and foreign, seek to persuade state agencies to pursue interests that favour them, inter-capitalist rivalry is often duplicated in the state machinery. On occasion, these divisions among rival capitalist factions are linked to the capture of certain state agencies.

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[79] John Kurt Jacobson, "Peripheral 'Postindustrialisation': Ideology, High Technology, and Dependent Development," in A Changing International Division of Labor (Boulder: Lynne Rienner Publishers, 1987), 95.

[80] Ibid.

[81] Rhys Jenkins, Transnational Corporations and Industrial Transformation in Latin America (London: Macmillan, 1984), 234.

But the policy responses that state agencies pursue towards transnationals depend on the general balance of forces between various classes or class segments at specific historical periods. They depend on how international economic conditions evolve and the opportunities and constraints that these present for each state. Cardoso and Faletto emphasise the value of analysing the impact of external variables on the internal structures of capital accumulation and how decision-makers in dependent states respond to those exigencies.[82]

The historical meeting of five circumstances, from 1985 to 1988, fundamentally changed the course of Indonesia's textile industry. From this time on, the manner in which the agenda was set led to a replay of inter-capitalist rivalry within the state apparatus. In this encounter the state was not unified. Different interests came to be represented in different segments of the state apparatus.

In 1985 two events on the international scene were directly related to the textile industry - cotton prices fell and growing protectionism in the United States forced the Indonesian government to succumb to U.S. government pressure to dismantle the Sertificat Export, a system of subsidies that it had put in place in 1983 to promote textile exports.[83] Two broad domestic transitions were underway which were inextricably related to an international event, falling oil prices. Falling oil prices set in motion an internal debate about de-regulation and the need to dismantle the highly protected sole agencies, viewed by many as the root cause of Indonesia's lack of competitiveness in international markets. This forced the state to give priority to non-oil exports, among which textiles featured greatly, the implications of which I will discuss in the next chapter.

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[82] Fernando Henrique Cardoso and Enzo Faletto, Dependency and Development in Latin America (Berkeley: University of California Press), 1979.

When cotton prices fell, spinning companies including the state-owned firms Sandang I and Sandang II, began to import cotton and were no longer willing to consume inferior quality domestically produced cotton. Now the interests of the small-scale cotton growers became a question of state concern. The Director-General of Plantations consulted with the Department of Trade to determine how best to ensure the welfare of local cotton growers. In this instance, since the public debate on privatising unprofitable state enterprises was underway, it was not considered politically opportune to make the state enterprises, Sandang I and Sandang II, take on the role of subsidising local cotton growers alone. The state sought the assistance of private enterprise, domestic and foreign, to share this burden. This policy its roots in the state's legitimation function. Suharto had made the welfare of local cotton growers his personal agenda.

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[83] By 1983 the government had recognised the need to enhance non-oil exports. Gradually, the government gave grudging and selective protection to various segments of the export-oriented industry. In 1983 it implemented the SE to give subsidies to garment and fabric exporters. But these advantages did not benefit the upstream synthetic fibre and filament producers who remained primarily suppliers to downstream producers. It was the S.E. that had created the problem for polyester producers because now spinners could import more freely.

As structural marxists would argue, the state juggles three functions - legitimation, security and accumulation. The state must decide when to give priority to one or the other of these often contradictory roles.[84] The Indonesian state was no longer willing to bear the costs of the welfare function, which falls into the legitimation category, alone. The question here is: how does the state get transnationals and local firms to mitigate their respective global and local profit-making goals?

After discussions among officials of the Directorate General of Plantations, the Department of Trade, and the Indonesian Textile Association (Associasi Pertekstilin Indonesia - API) representatives, on 5 December 1985, in response to an API proposal, Trade Minister Rachmat Saleh issued two decrees that gave the association the power to ensure that local cotton was consumed.[85] The decrees required all spinning companies to consume domestic and imported cotton in a 1:10 ratio.[86] API would only issue cotton import permits when the spinning companies provided the association with proof of local cotton purchases. The API leadership directed the spinners to relinquish their independent importing authority to the association so that it could implement Saleh's decrees. During 1985 the Ministries of Trade and Industry and industry associations contemplated various strategies to fund exporters when the Sertificat Export elapsed on 30 March 1986.[87] In the early months of 1986 API proposed that the upstream spinning industry should subsidise export-oriented garment and fabric manufacturers. API would collect the levy and redistribute it.[88]

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[84] For an excellent discussion of the contradictions between the state's legitimation and accumulation functions see James O'Connor, The Fiscal Crisis of the State (New York: St. Martin's Press, 1973), esp. chap.1.

[85] Ministry of Trade Decrees no. 1966/KP/XII/85 and no. 1067/KP/XII/85.

[86] Since local production constituted only 5 percent of total local consumption it is unclear why consumption of local cotton was fixed at a 1:10 ratio. One critic explained, "Government officials love to create a scarcity because this enhances their bargaining power with local producers." Textile consultant, Jakarta, 18 December 1986.

The imminent abolition of the S.E. in response to U.S. government pressure had incensed Indonesian government officials - which they described it gross interference in Indonesia's internal matters.[89] API's leaders went along with this interpretation and did much to publicise it. They were an articulate group of men, well-versed in international and domestic textile matters.[90] Their speeches and writings were meticulously researched, which gave them much credibility within and without government circles.

The textile industry had consumed Safion's entire career since the 1950s in various capacities. He had served as the first Director General of Textiles in the New Order regime until 1973; in various advisory capacities on international and domestic forums; as a Director of one the major textile conglomerates, the Sandratex Group, headed by the Chinese Indonesian Handoko Tjokrosuputro. Then there was Musa, the pribumi spokesperson for The Nien King, the Chinese Indonesian who controlled the most expansive textile empire in Indonesia and who had a minority share in the Japanese polyester fibre producing company Kuraray Manunnggal. Both the Sandratex and the Kuraray groups together controlled 50 percent of total polyester fibre production.

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[87] Former high-ranking textile consultant, interview by author, Jakarta, 14 February 1987. Corporate executive, state-owned firm, interview by author, Jakarta, 21 January 1987. Textile consultant, interview by author, Jakarta, 8 February 1987. This was the result of the government's decision to sign the GATT code on Subsidies and Countervailing Duties following protectionist pressures in the United States, Indonesia's largest textile importing country.

[88] Two foreign textile consultants, interview by author, Jakarta, 11 March 1987.

[89] High-ranking government official, interview by author, Jakarta, 24 March 1987.

[90] See for instance, Frans Seda's insistence at a one-day seminar, on prospects of Indonesia's non-oil exports of Indonesia's non-oil exports, that Indonesian embassies, consultate generals and trade protocol centres (ITPCs) should conduct market studies to promote Indonesian exports. Drs. Frans. Seda, The Jakarta Post, 25 March 1988. Also see Drs. Frans. Seda, "Implications and Ramifications 'Jenkins Bill'," Kompas, 21 October 1985.

On 13 January 1986 a private trading company was unobtrusively formed composed of a coalition of a few of Indonesia's largest textile producers, including several members of the API executive and the Argo Manunnggal and Sandratex group.[91] In three 18 February and 6 March decrees, Minister of Trade Rachmat Saleh transferred the import and subsidy issue from API and put into the hands of CBTI. It was given the sole rights to procure cotton and synthetic raw materials including rayon viscose fibre and polyester staple fibre.[92] It would effectively control demand and supply and charge a levy.

This was the crux of the issue. A sole agency, composed of a coalition of some of the industry's most powerful domestic and foreign industrialists, had monopoly rights over the import of cotton and synthetic fibres. Some were integrated through joint ventures with Japanese firms and with vertically integrated interests ranging from synthetic fibre production to garment production.

P.T. CBTI would satisfy various interests, which reflected the fragmented structure of the textile industry. CBTI would satisfy the needs of local cotton growers and thus the interests of the state agency, the Directorate General of Plantations and Suharto's personal legitimation agenda. It would satisfy the interests of Trade Minister Rachmat Saleh, who as a technocrat found the idea of private industry subsidising its own export drive appealing. Indeed, a 1983 World Bank report Indonesia: Policies for Growth With Lower Oil Prices had urged the government to encourage the growth of private trading houses in the export drive so that the state's role would be restricted to that of a catalytic agent. For the private industrialists who formed it, CBTI represented the first move towards the establishment of a sogo shosha variety general trading firm on a smaller scale.[93]

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[91] "The Indonesian Textile Industry: Its Development and Problems," The Indonesian Commercial Newsletter, 12 May 1986. The Sandratex group also owned Tri Rempoa, the first wholly-owned domestic polyester company.

[92] Ministry of Trade decree no. 70/KP/II/86, 18 February 18 1986; Minister of Trade decrees no.82/KP/III/86, 6 March 1986 and no.83/KP/III/86, 6 March 1986.

CBTI would satisfy the interests of the large vertically integrated textile conglomerates such as Argo Manunnggal and Sandratex, which had an interest in controlling polyester fibre imports in conjunction with their Japanese allies dissatisfied as they were with the government's mercurial protection policy since 1979. They could, earn a commission for every kilo of cotton that passed through their hands. They could in effect, control the whole industry, keep supply and demand in balance to suit their interests and fix prices accordingly. Argo Manunnggal and Sandratex also dominated garment and fabric exports so that they would be major beneficiaries of the cross-subsidisation of fabric and garment exports by the spinning firms.

This is an instance of how a powerful fraction of the capitalist class set the agenda in such a way as to make it appear that its interests coincided with the general interests of the industry. But it had to set the agenda in such as a way as to coincide with state policies and welfare concerns.[94] It is also an instance of how alliance formation takes place between state agencies and fractions of large foreign and local capital.

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[93] Former high-ranking government official, interview by author, Jakarta, 14 February 1987.

At first the spinning and integrated spinning/weaving firms responded with mute disbelief. Feeling doubly squeezed, the non-integrated spinning companies found both requirements untenable. The spinners argued that the inter-firm subsidisation of fabric and garment firms would primarily benefit CBTI members and other large integrated firms.[95] But the CBTI turned a deaf ear to their complaints. In its first decision in early April 1986, the CBTI decided to impose a levy of Rp. 900/kg for cotton fibre and Rp. 100 for synthetics. Following vociferous complaints from the cotton consuming companies, the levy was changed to Rp.450/kg on 28 April 1986 for cotton and polyester.[96] The CBTI began to issue decrees as if it was a government agency. It informed the spinning companies that CBTI's approval of their Letters of Credit was contingent on their written consent to abide by the levy.[97]

For now, the CBTI could present itself as a good corporate citizen seeking to safeguard the general welfare by ensuring that the local cotton producers were protected and that private industry would no longer be a burden on society and state. Private industry would finance its own export drive and bring rich revenues to the state. The foreign and domestic spinning companies could be portrayed as selfish capitalists and as a drain on a cash-strapped government, undermining the interests of powerless cotton growers, the local industry, and the state when they favoured imported cotton and synthetic fibres.

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[94] For instance on 3 June CBTI argued that it was in the national interest to impose the levy to protect local cotton growers and to promote Indonesian fabric and garment exports. Sinar Harapan, 4 June 1986. Bisnis News, 4-6 June 1986.

[95] In 1986, based on the past performance criterion, the government had granted between 60-87 percent of export quotas to four companies - Batamtex, Eratex, Dan Liris, and Sandratex. Vaudine England, " Virtue from Necessity," Far Eastern Economic Review, 5 February 1987, 47. Two of these firms belonged to the P.T. CBTI group. The Argo Manunngal group controlled the P.T. CBTI agenda under the leadership of Musa.

[96] Decree of the Board of the CBTI No. 02/SK/CBTI/4/86, 28 April 1986.

[97] Telex No. T-49/CBTI/4/86, 29 April 1986.

The structural relations between the state and civil society and within various fractions of civil society play a significant role in the manner in which political activity is organised. In other words, the structural characteristics of the state and civil society constrain the manner in which local and foreign capital can seek changes in state policy that favour their interests. There was too much public animosity towards foreign and Chinese investors for them to organise and sustain a political debate in Indonesia. Public activity was the sole preserve of Indonesia's pribumi children. Consequently, the CBTI leadership and the API leadership were dominated by pribumi Indonesians, the traditional holders of political office and of public or private representation in Indonesia. Rachmat Saleh and API's leadership utilised the existing institutional framework, the sole agency phenomenon, to derive legitimacy for the P.T. CBTI monopoly. Only a pribumi Indonesian could challenge its existence. Aminuddin, a brusque man with a great deal of gumption, the owner of Indonesia's sole large pribumi yarn spinning company, arose to fight the cause with the aid of several domestic Chinese and Indian and foreign Indian and Hong Kong spinning firms.

In Indonesia, political activity was still highly restricted by the bureaucratic-authoritarian regime. Business lobbies required military clearance and approval. A debate on monopolies owned by families close to key military political office-holders was still dangerous political activity. After establishing that CBTI derived its political support merely from the technocratic Minister of Trade, Rachmat Saleh, Aminuddin exploited the wider public debate on monopolies and conglomerates, considered to be major inhibitors in Indonesia's attempt to achieve international competitiveness, to push the cause of dismantling CBTI. Aminuddin began the process of organising an unprecedented oppositional force against the sole monopoly.

The agenda was set in two ways: first, that conglomerates were undermining defenceless non-integrated spinning firms, although many of them were larger, integrated firms; second, that import-substituting firms were undermining the interests of export-oriented firms although only the larger foreign and domestic firms fell into that category. Aminuddin did this with some political dexterity and with the aid of changing structural conditions in the international and domestic environment. Thus began a saga of open, vociferous conflict between the CBTI and a new organisation called Sekbertel that was born on the 6th of May 1986.[98]

In other words, Aminuddin seized on the opportunity presented by the meshing

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[98] As it will be recalled, he had in the early New Order Years sought to create a textile association outside the framework of Indonesia's corporatist functional group structure but had failed because of the New Order's repressive restrictions on political activity. Aminuddin's new aggressive stance provided the impetus for the formation of another representative association. This association, the Joint Secretariat for the Indonesian Garment Industry. It was established by a group of textile industrialists and exporters from Jakarta Raya and West Java, headed by a coordinator, Mrs. Wien Dewanta, a professional lawyer. This association challenged API's dominance over export matters. It justified its existence on the grounds that President Suharto had always emphasised the need to enhance foreign exchange earnings through exports of non-oil products.

of international and domestic factors to turn the course of events in the Indonesian textile industry to favour his cause and the cause of other domestic and foreign capitalists. As Evans points out, if moments of transition are not seized then they cannot become opportunities.[99] But international and domestic conditions have to change to become opportunities. In Indonesia, if changes had not occurred in the international and domestic environment, major structural changes in the industry might not have been effected. The fragmentation and inter-capitalist rivalry within the stronger segment of the capitalist class might not have been so intense. The winners and losers would have been different.

This was an obvious example of agenda-setting by a coalition of transnational and domestic corporations. But state agencies cannot just be captives. The capitalist class or fractions of it must provide ample proof that their interests coincide with those of the state. They cannot set an agenda of their own choosing. They must wait for the opportune moment, when they can show that their agenda coincides with that of the state agencies.

The May 6 Package(PAKEM) was the fundamental watershed decision that conclusively signalled that the state had made the transition to an export-oriented strategy. It explicitly allowed producers exporting more than 85 percent of their production to import raw materials if domestically-produced products of the same specification were less competitive than imported materials.[100] In support of the spinners, Minister of Industry Hartarto and the Director-General of Multifarious

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[99] Peter B. Evans, "State, Capital, and the Transformation of Dependence: The Brazilian Computer Case," World Development 14 (1986), 804.

[100] Peat, Marwick and Mitchell, "A Market Survey," 33.

Industries had urged the CBTI not to implement measures that might contradict the essence of the May 6 policy package.[101] But on May 6 itself, the CBTI openly defied Hartarto's directive by implementing the levy because it had the tacit support of Trade Minister Rachmat Saleh. With this move the rivalry that had thus far been primarily played out in the arena of civil society now was transported into the state apparatus.

From 6 May 1986, the battle lines were drawn clearly between two warring factions. One faction consisted of CBTI, the Ministry of Trade, and the BKPM Chairman Ginandjar Kartasasmita. The other was comprised of the Ministry of Industry and the Sekbertel following. This group also got some support from Bappenas Minister Sumarlin and Finance Minister Ali Wardhana. Suharto was to be the ultimate arbiter in this murky case. In the Indonesian context, the matter became one of high politics. Suharto had never become directly involved in settling a textile dispute. But the increasing power of textile industrialists and the increased importance of the industry in the export sector had changed this.

With the package a new department, Pusat Pengelolaan Pembesan dan Pengembalian Bea Masuk (P4BM), housed in the Finance Ministry, headed by the technocrat minister Ali Wardhana, was created to administer these new import regulations and aid local producers to track prices. The creation of the P4BM reaffirms the view of bargaining balance of power and dynamic dependency scholars that when new problems are thrown up for the state to resolve, it creates new institutional structures; such agencies enhance the efficacy of state agencies to regulate transnationals.

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[101] Telex no. 100/TLX/5/1986, DEPIND JKT, 6 May 1986.

The P4BM naturally became aligned with the polyester importing Indian and Hong Kong investors since its prime task was to enable a comparison between domestic and international prices. In the midst of the conflict, the Indian and Hong Kong investors had actually used CBTI's services in April and early May.[102]

> But we also tracked prices. They sought to control imports in the guise of giving a service to their customers. These imports came from their sister companies in Taiwan and South Korea and their parent company in Japan. They imported huge quantities so that they could control supply, argue that they had huge inventories so that they could fix prices.[103]

But the May 6 package did not prove to be a decisive victory for the Sekbertel faction because CBTI remained entrenched. The Indian investors, armed with the support of the Ministry and the new institutional framework, refused to carry out CBTI's directives. CBTI blocked their letters of credit. Between May and August P.T.CBTI ignored repeated instructions from the Ministry of Industry to revoke the Rp.450 levy and to stop obstructing the importing companies' letters of credit.[104] Instead, CBTI began a defamation campaign to discredit Sekbertel as a national security threat, and as "a group of protestors (Kelompok petisi) unwilling to obey state directives.[105] To secure his personal safety and the longevity of his newly-formed organisation, Aminuddin retaliated with a press conference, a widely disseminated press release, and a letter to

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[102] Production Manager, Indian transnational, interview by author, Bandung, 7 August 1987.

[103] Managing Director, Indian transnational, interview with author, Bandung, 3 August 1987.

[104] For the delay of the Dasatex Ltd. letter of credit see Sekbertel Letter no. 004/SEKBER/5/1986, 27 May 1986; For various Ministry of Industry instructions to P.T. CBTI see Telex no. 113/TLX/5/1986. DEPIND JKT, dated 21 May 1986. Also see Sinar Harapan, 31 May 1986 and Telex No. 189/TLX/VIII/1986, 6 August 1986.

[105] Tempo, 9 August 1986.

Suharto emphasising that Sekbertel's objectives were economic not political.[106] At this press conference the two Indian companies, P.T. Elegant and P.T. Sunrise warned that they were reviewing their expansion plans because of CBTI's stubborn obstruction of their operations.[107]

The Japanese transnationals could not bring their ownership-specific advantages to bear because local capital and the state no longer depended on them for capital, technology, and markets. This is one reason why transnationals in industries with standardised technologies hold on to majority equity with great tenacity since it is their sole source of longevity.

When transnationals cannot bring their firm-specific advantages to bear in bargaining with host governments they must turn to other resources to persuade host governments to make policy that favours them. In the obsolescing bargain model, economic nationalism is seen as an expression of rational self-interest and a bargaining resource for host governments. But economic nationalism is not only a bargaining resource for host governments. Transnationals can turn it into a weakness. When transnationals are aware of the importance that state agencies attribute to import-substituting industries as a sign of national control, they seek to transform this sensitivity into an advantage for themselves. They have learnt to set their agenda in such as way as to coincide with entrenched orientations in the state apparatus. This risk-reducing mechanism that Moran omits can be added to his list.[108]

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[106] In May Sekbertel had registered itself with the security forces to obtain state recognition to guard against being considered politically subversive. Aminuddin also astutely chose the name Sekbertel, to stir associations of the original name for the state political party, Sekber-Golkar. President, local firm, interview by author, Jakarta, 5 February 1987.

[107] Ibid.

The Japanese transnationals sought to exploit this weakness by bringing the dire consequences that the Duty Drawback system would have for import-substitution industrialisation and the backward linkages that the government sought in the form of the new Aromatics Centre to the attention of Kartasasmita and Suharto. In a formal document to Kartasasmita on 29 July 1986 the fibre producers had outlined their concerns and demands.[109] They argued that they were negatively affected by the Duty Drawback System of PAKEM. They were unable to cope with the duty-free import of raw materials when these were produced locally. The Drawback System had become an "import promotion" program rather than an "export promotion" program. Local garment and textile manufacturers had already contracted to buy fabric, yarn and polyester staple fibre from Taiwan, Hong Kong, Pakistan, and Korea. These moves endangered the health of the local industry, whose main aim was to obtain protection or subsidies from the government. They argued, "It is necessary for the government to re-study the present structure of import taxes or grant special discounts of purified therephtalic acid (PTA) to upstream industries from Pertamina's Aromatic Centre."[110] The Japanese transnationals set the agenda in such a way that it appeared that the Sekbertel faction was defying the national interest, a plea to which Suharto had responded.

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[108] Moran, "Risk Assessment."

[109] "Export Promotion of Non-Oil," Unpublished confidential document sent to BKPM from polyester fibre producers, 29 July 1986. This document followed closely on the heels of a meeting between Kartasasmita and the Japanese investors arranged by Hiroshi Oshima, the Director of JETRO's Indonesia office. Hiroshi Oshima, Japan External Trade Organisation, interview by author, Jakarta, 8 May 1987.

[110] "Export Promotion of Non-Oil", Unpublished confidential document sent to BKPM from polyester fibre producers, 29 July 1986.

Bustanil Arifin, the Acting Minister of Trade in Rachmat Saleh's absence, Kartasasmita, and Hartarto met with Suharto, but the outcome suggests that Hartarto was overpowered by the other two men. On August 11 Suharto ordered that CBTI be reorganised to make it more representative. Aminuddin lauded this as a personal victory. But Suharto revoked Hartarto's special importer-licenses to the spinners and gave explicit support to CBTI's mandate and strategies.

But Suharto's decision did not satisfy the Indian investors.[111] He had ignored their earlier threat that they would not continue their export-oriented expansion plans. They understood their own importance to the Indonesian export drive and they knew that the May 6 package favoured their cause. The polyester fibre-consuming companies were angrily asked why domestic prices for polyester staple fibre were still 40 percent above the international price when Pertamina was selling basic raw materials to the fibre producers at international prices. On 24 August P.T. Sunrise and P.T. Elegant reiterated their threat to cancel their expansion plans, arguing that their inability to import had reduced their efficiency. Mr. K.K. Aggarwal, the director of P.T. Sunrise Bumi, pointedly posed the rhetorical question, "Who has the authority to grant an import license, P.T. CBTI or the government?"[112] He had provoked Suharto to respond. How could Suharto allow a challenge to state legitimacy pass unanswered?

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[111] For a discussion of some of these issues, see Makarim Wibisono, "The Politics of Indonesian Textile Policy," Bulletin of Indonesian Economic Studies 25 (April 1989), 41-51.

[112] Jawa Pos, Surabaya, 25 August 1986. President-Director, Indian transnational, interview by author, Jakarta, 5 July 1987.

Liberal economists correctly argue that foreign direct investment that depends primarily on trade barriers and subsidies for its existence may promote inefficient import-substitution without economies of scale and other multiplier effects.[113] Kudrle argues that "import-substituting firms are among the strongest purveyors of the ideology of economic nationalism."[114] The fibre producers now launched an attack on the Indian investors that would have delighted any economic nationalist. They argued that the Indian investors' threat to cancel their plans was an "insult to Indonesia as a free and independent nation."[115] In this they received Kartasasmita's support.[116] But they were not successful in turning the tide against the Indian investors.

In this instance, it is clear that the priority a host government gives to a project has a significant effect on the extent to which the foreign investor can neutralise its bargaining power. It is not, as several analysts of bargaining argue, that the power of incumbent transnationals will invariably increase in manufacturing industries after the initial investment and that it is only at the time of the initial investment that the host government's bargaining power is at its peak.

As this case shows, the bargaining power of the Indian and Japanese investors followed the pattern that scholars such as Vernon and Moran describe with respect to natural resource industries. Moran argues that the shifts in bargaining power between transnationals and host governments are repeated before and after each new corporate commitment. When corporations bring new resources to the host state their bargaining power is at its peak. When they have little new to offer the host government, they lose their importance and their bargaining power. Before the Indian investors finalised their expansion plans they could threaten the government with cancellation. The government had to give credibility and weight to that threat. The relative importance and potency of bargaining resources had shifted in favour of the Indian investors and against the Japanese investors. The Japanese polyester fibre producers were dispensable for they had sunken investments and no new investment schemes. Indeed, the Indonesian state had deprived them of the latter resource.

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[113] Stephen Gill and David Law, The Global Political Economy: Perspectives, Problems, and Policies (Baltimore: John Hopkins University Press, 1989), 203.

[114] Robert T. Kudrle, "The Several Faces of the Multinational Corporation: Political Reaction and Policy Response," in An International Political Economy ed. W. Ladd Hollist and F. Lamond Tullis (Boulder: Westview Press, 1985), 192.

[115] Berita Buana, 26 August 1986.

[116] Ibid.

The government now had to choose between protecting the upstream synthetic fibre producers who were contributing to the high-cost economy or to the Indian investors who were expanding their plants to become foreign-exchange earners. Host governments are vulnerable. Hartarto met with Suharto to discuss the Indian investors' threats. The fibre producers themselves had admitted in mid-1986 that while domestic demand was 8,000 tons/month and production was 6,300 tons/month the excess demand had to be met by imports.[117] Repudiating the transnationals' claims that they had huge inventories in storage, Hartarto presented those figures to Suharto.[118] The result was that Hartarto reinstated the fibre importer-licenses.

By tracking prices and domestic demand, the Ministry of Industry and the P4BM could challenge the Japanese transnationals' pricing structure and demand and supply calculations that had previously been accepted without question. When state agencies take the trouble to understand the workings of the industry, they are in a better position to control and challenge it. They can counter the industry's sombre counsel for the continued prosperity of the industry with their own newly acquired knowledge. They can separate their own objective interests from the interests of the industry which seeks to present its own interests as those of the state. Further, when the state's objective interests change in time, it succumbs to its more valuable clients. With the aid of the P4BM and Indian, Hong Kong and domestic investors, the Ministry of Industry could illuminate the real interests of the state.

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[117] Peat, Marwick and Mitchell, "A Market Survey," 48.

[118] High-ranking government official, interview by author, Jakarta, 24 March 1987.

The existence of arm's-length prices for synthetic fibres and the existence of many players in the market enabled the state to achieve the necessary information to challenge the transnationals' prices. But this information had been available all along. That the state did not seek to obtain it, that it did not intervene in the price-fixing strategies of the transnationals before, and that when it did, it did so only at the behest of private industry, suggests that the state's decision not to act was the product of a conscious policy decision to protect the synthetic fibre producers with government-generated market imperfections to achieve its goal of import-substitution industrialisation. Since the issue was not given priority, the state did not create adequate administrative capabilities to monitor the synthetic fibre producing transnationals' pricing strategies. Its decision not to act was the product of a lack of political will.

Still in the short-term, the PSF producers partially stemmed the deregulation tide.

Throughout 1987 the PSF producers continued to charge high prices to firms that did not meet the government's 85 percent of production export requirement. In August 1987 an executive of an Indian polyester consuming company noted, "A dual-pricing structure is emerging for the domestic market and for the export market. For the export market the fibre producers have been forced to provide better prices because local exporters can take advantage of cheaper, subsidised imports."[119]

Unfortunately, the sister spinning/weaving companies of the large synthetic fibre producers did not benefit from the government's new liberalisation policies. They were held hostage by their parent companies. After the saga was over a Toray joint venture executive observed, "Toray expects us to buy our raw materials from them even if we can get better terms elsewhere."[120] But the deregulation package of 25 October 1988 dealt the final death blow to the system of protection that the polyester fibre producers had enjoyed. Synthetic raw materials were completely deregulated, signalling a victory for Hartarto, the Indian and Chinese and Hong Kong investors, those Japanese investors that were not affiliated with the synthetic producing companies, and for the liberal technocrats who sought deregulation in all forms. Jagdish Baghwati has commented that even in industries with a few contenders, host governments will be more successful in promoting competition with liberalisation because protection produces non-competitive behaviour. In the competitive era of the 1980s and 1990s states are not willing to use market imperfections to lure foreign investors.[121]

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[119] Managing Director, Indian transnational, interview by author, Bandung, 6 August 1987.
[120] General Manager, Japanese transnational, interview by author, Jakarta, 21 April 1987.
[121] Jagdish Bhagwati, Protectionism (Cambridge: Mass, The MIT Press, 1988).

Aminuddin's victory lay in another quarter. CBTI was dismantled and Sekbertel became the ascendant representative of the textile industry at home and abroad. The CBTI saga ended in mid-1988. But this had not been a battle between the forces of good and evil as the media, some academics, and Aminuddin himself had portrayed.[122] It was a battle between profit-oriented and powerful companies. An impartial observor in this highly politicised drama noted, "Many spinning companies, including Aminuddin, who portrayed himself as the defender of smaller, non-exporting spinners made the largest profits(compared to other sectors of the industry) during the devaluation of September 1986. Many spinners hoarded yarn till retail prices went up. Mr. Aminuddin reportedly made a profit of 100 million rupiah for 100 bales of yarn."[123]

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[122] For a decidedly one-sided portrayal which does not examine the objective interests of the Sekbertel faction and depicts Aminuddin and the other spinners as victims, see Andrew J. MacIntyre, Business and Politics in Indonesia (Sydney: Allen and Unwin, 1991), chap. 2. A comparison of MacIntyre's portrayal and my interviews with Aminuddin suggest that the former took the latter's depiction of the issues at face-value. MacIntyre analyses the cotton issue in detail, the issue that interested Aminuddin most because he himself was a cotton spinner. It was also the issue that was politicised much more than the polyester staple fibre issue. In fact, the PSF issue hardly received much attention except in relation to the whole raw materials issue. Also Aminuddin primarily directed his attack against the indigenous Indonesians who controlled the public relations aspects of the Chinese/Japanese coalition, not the Japanese/Chinese producers themselves. It was those representatives he harmed most when he eventually succeeded in getting Kadin to officially recognise the rival organisation, Federation of Indonesian Textile Industries (FITI), as the official representative of the textile industry in foreign and domestic forums. FITI combined four associations - APSYFI, the synthetic fibre association, Sekbertel, the spinning association, ASPINDO, the finished textile manufacturers association, and PIBTI, the garment manufacturers association. For the growing dispute between API and FITI as legitimate representative of the industry see The Jakarta Post, 24 August, 3 September, 18 November 1987. For the refusal of Suharto and Hartarto's refusal to settle the dispute see Indonesian Observor, 27 August 1987.

[123] Corporate executive, state-owned firm, interview by author, Jakarta, 10 March 1987.

In April 1988 the Sekbertel leadership persuaded the government to demolish the regulation requiring private spinning mills to consume local cotton.[124] The state could not force foreign and domestic private firms to carry out its social and political functions, in other words, its legitimation functions. State enterprises were forced to bear this burden alone. Once Aminuddin and his following had gained ascendancy, they could focus on the inferior quality of domestic cotton. They could argue that in the interests of efficiency, productivity, and, if they were export-oriented firms, the achievement of international competitiveness, they could not consume it.[125]

Commenting on the alliances between Mexican local firms and transnationals Evans notes that when "social tranquillity" is to be protected, domestic capitalists combine with transnationals.[126] Domestic capitalists embrace nationalism when their accumulation goals conflict with those of transnationals. But when state nationalism focuses on distribution and welfare, then local capital, concerned as it is about accumulation and profit, aligns with foreign capital.[127]

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[124] For the textile spinning firms refusal to accept low quality cotton fibres sold by state companies see The Jakarta Post, 5 April 1988. For their complaints see "Poor Local Cotton Fiber Causes Severe Losses to Spinning Firms," The Jakarta Post, 28 March 1988. A few months earlier, on behalf of the spinning industry, Aminuddin had agreed to participate in protect the small-scale producers from the negative impact of market fluctuations by accepting the government-set price of US$1.6 per kilogram. The Indonesian Observor, 4 October 1987.

[125] See for instance, Minister Hartarto's symathetic response to the spinning companies complaints about poor quality cotton and their criticism of the government's requirement that they utilise 9.09 percent of locally produced cotton. The Jakarta Post, 12 May 1987. In January 1988 Minister Hartarto reiterated his support and promised to bring the issue to Suharto's attention when foreign firms complained that the quality of domestically produced cotton was damaging the quality of their yarn. The Jakarta Post, 5 January 1988.

[126] Evans, Dependent Development, 306.

[127] Ibid.

The growth of the state sector and the objectives that the state hopes to achieve vary considerably across industries. In Indonesia, the state was directly involved in capital accumulation in the textile industry through its state enterprises. In this sense, the state entered the market as a competitor to private domestic and foreign firms. In joint ventures it was allied with transnationals as a subordinate partner. But in its capacity of state qua state, it did not provide state enterprises with the capacity to challenge or compete effectively with private capital. State enterprises were left to fend for themselves in their equity battles with foreign investors.

"Although state entrepreneurship produces goods that are marketable, it intermittently or systematically embraces goals other than profit maximisation, claiming to produce economic or political benefits that could not be expected from private firms."[128] The state's own contradictory interests may prevent state enterprises from competing with private firms on profit. Indonesian state enterprises were created to occupy three rather contradictory roles - development agents, economic stabilisers, and profit-makers - in that order. Pelita III had called for expanded state activity to reduce the effects of market fluctuations on small and medium weaving establishments.

Gereffi has shown that Mexico's barbasco producing state enterprise, Proquivemex, willingly defined nationalism in distributive terms.[129] Indonesia's textile state enterprises were less forceful and less autonomous than Pertamina. They took their directives from the Ministry of Industry and the Ministry of Finance. It can be generalised that state enterprises that depend on the state's largesse for their existence, are less likely to overstep the mandatory boundaries and to challenge state autonomy.

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[128] A. M. Choksi, State Intervention in the Industrialization of Developing Countries:Selected Issues (Washington D.C.: World Bank, 1979).

[129] Gary Gereffi, "The Renegotiation of Dependency and the Limits of State Autonomy in Mexico (1975-1982)," in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. Theodore H. Moran (Lexington, Mass.: Lexington Books, D.C. Heath, 1985), 83-106.

In the 1974-1979 period, when economic nationalism had focused on welfare oriented-accumulation rather than accumulation for large capitalists across the pribumi/Chinese cum foreign capital divide, the latter had been forced to take on the foster-parent role for their less privileged weaving counterparts in a limited way. But the main task had fallen to state enterprises. For the state to have demanded that private enterprises carry the major share of this burden would have imperilled the long-term goals of capital accumulation. This augured a clear division of labour between state enterprises and private capital. Gereffi has argued, when state firms fulfill the state's social and political goals, conflict between the state and foreign capital is less likely.

In Indonesia, nurturing small and medium enterprises became the task of state-owned enterprises. They were to be foster parents and to provide a safety-net for the small and medium entrepreneurs, many of whom went under during the busts that the textile industry frequently faced. In performing this task, they were to mitigate their profit-making appetites, exercise moderation in pricing the yarn they sold to their "foster children" and to ensure supply security.

> Sometimes it is difficult to perform the profit-making role because we have to support the small-scale industry, provide them with technical assistance, and supply them with the required raw materials at below market prices. For instance, after the September 1986 devaluation, yarn prices soared. We could have made huge profits but Minister Hartarto told us to pursue the development role - to sell our yarn to small-scale weavers

> at below market prices. Sandang lost out because of this policy while other private companies accumulated huge profits. They took advantage of the exchange rate differential by hoarding and later passing on the increased costs to consuming companies.[130]

The state enterprises could not pursue an aggressive export-oriented strategy. The sharp appreciation of the yen after 1985 combined with the September 1986 devaluation had opened up new markets for Indonesian yarn exports. Yarn which fetched U.S.$618 to U.S.$1030 per ton before the devaluation could now be sold in Europe for U.S.$1238 to U.S.$1327.[131] "We never had access to so many buyers. But our function was to serve the whole industry so that we could not think of profitability and competitiveness. We could have made extremely high profits on the international market but we cannot be export-oriented like private companies."[132]

While state enterprises were expected to underwrite small-scale weavers they were also expected to subsidise local cotton growers. This prevented them from generating high profits, essential for internal growth and expansion. The state-enterprises absorbed all locally-produced cotton when futures market prices were high but they were less willing to consume it when futures market prices were low in 1985 and 1986. "State capital itself tends to reproduce the patterns of behaviour of private capital as individual state firms seek to free themselves from their obligation as state capital and realise their nature as capital."[133] But Hartarto prohibited the state enterprises from importing cotton at the request of the Directorate-General of Plantations. In 1988 the state was forced to abandon its desire to reorganise the subsidisation role because it could not withstand the consolidated power of foreign and domestic capital. State enterprises were forced to re-embrace their handmaid role.

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[130] Technical Director, state-owned company, interview by author, Jakarta, 27 April 1987.

[131] Ibid.

[132] Ibid.

[133] Rhys Jenkins, Transformation in Latin America, 235-6.

This discussion has two other dimensions that are relevant from the bargaining "balance of power" and dynamic dependency perspectives. The first dimension deals with transnational divestment. The second deals with equity transfer.

Kuraray decided to divest its shares in P.T. Kuraray Manunnggal because it could no longer partake in a "defensive oligopoly." Further, it preferred to divest rather than to transfer majority equity to its domestic partner, Daya Manunnggal.

Transnationals have not been able to prevent their domestic rivals from emerging as competitors through the risk-reduction strategy of a joint venture. Host governments have encouraged domestic firms to emerge as competitors to foreign firms. Many domestic firms have successfully neutralised the value that transnationals had hoped to obtain by tying potential rivals into joint ventures.

Nanshi Matsuura notes that the investment and technology licenses that Japanese transnationals imparted to their South Korean partners enabled them to emerge as competitors. He notes that Japanese firms were unwilling to relinquish equity ownership in response to stricter host country performance requirements.[134] Consequently, more than half of the 450 Japanese firms operating in South Korea divested between 1981-

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[134] Nanshi F. Matsuura, "Management Conflict and Foreign Direct Investment: The Case of Japanese Investment in South Korea," The Columbia Journal of World Business 24 (Summer 1989), 63-64.

1987.[135] Divestment, rather than the transfer of majority equity, seems to have been a common strategy pursued by Japanese transnationals as their industrialising country counterparts climbed the learning curve and the ladder in the hierarchy of global capitalism. In this context, Vernon's theory of workable competition is valid.

When transnationals lose their compensating advantage because of reduced government protection, an inability to derive oligopolistic rents through high transfer prices for raw materials, and the infiltration of rivals - domestic public or private firms or transnationals - they will prefer to withdraw. This was the basic assumption underlying Hymer's original hypothesis for foreign direct investment. The major difference between natural resource and manufacturing firms is that the latter are elusive. They can leave. The conclusions of scholars such as Gereffi, Bennette and Sharpe, and Kobrin are upheld when they argue that it is more difficult for host governments to hold transnationals hostage in the manufacturing industries.

The key question to be asked is: do host governments and local firms care to hold transnationals hostage when they refuse to divest majority equity to local partners that can duplicate their functions? It also raises the issue of conflict between local and transnational capital and their diverse interests. In the preceding sections of this chapter I have shown that in alliance with certain sections of local capital, fragmented segments of foreign capital may be on a collision course with other fractions of allied domestic and foreign capitalists. But these alliances may be issue-specific. Thus, local capital that is allied with foreign capital in a joint venture may jointly confront other capitalists to sustain the profitability of the joint endeavour. But within joint ventures themselves conflict may emerge because local capital and foreign capital have discordant objective interests.

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[135] Ibid., 61-64.

Bargaining is no longer viable and the host government and local capital no longer seek to hold transnationals hostage when they do not depend on their continued operation. In the Indonesian textile industry, it was not a moment of crisis for the host government and local firms when some transnationals decided to divest. In the second most technologically advanced sector of the textile industry, the Argo Manunngal group bought out the cumulative 70 percent shares of its two Japanese partners, Marubeni Corporation and Kuraray Co. Ltd. in P.T. Kumafibre.[136]

The second facet of this discussion deals with the transfer of equity ownership. In Indonesia, dummy and de facto minority partners had been unable to obtain majority equity share joint ventures.[137] Indian firms had deliberately chosen dummy partners. Well equipped with the entrepreneurial spirit, the Chinese partners in Japanese joint ventures remained junior allies. Daya Manunnggal's equity remained 30 percent throughout its association with Kuraray and Marubeni.[138]

Transnationals have often responded to host government demands to transfer majority equity to nationals by going public so that they can retain control over the operation. Encarnation's Indian findings corroborate this conclusion.[139] In Indonesia,

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[136] The Jakarta Post, 30 April 1987.

[137] Government bureaucrat, interview by author, Jakarta, 6 May 1987.

[138] Ibid.

[139] Dennis J. Encarnation, Dislodging Multinationals: India's Strategy in Comparative Perspective (Ithaca and London: Cornell University Press, 1989), 71.

Toray and Century Mills pursued this strategy in 1980.

It is as gate-keeper that the host government can impose more stringent terms on new entrants. But what has it to do with incumbent transnationals and their already existing relationships with private and public local firms? The real test for the Indonesian government came in the early 1980s. There were so many different questions to be settled. How were the shares to be appraised? Who would appraise them? And if the government did not intervene in this process, it was the stronger partner with control over decision-making who took the ultimate decision and so in fact had the power to appoint itself as the independent appraiser. In the mid-1980s, this independent appraiser had in many cases become an export-oriented firm with permission to expand its facilities with new foreign loans which enabled it to revalue its shares in the joint venture. In other words, transnationals could use their firm-specific assets to prevent the erosion of their equity stakes.

The managers of state-owned firms adopted a rentier approach to the issue of share reevaluation. They argued that the considerable appreciation of land and building, their initial contribution to joint ventures, gave them a legitimate right to increased equity. A Sandang manager complained that even in the 1980s, for its contribution, land and the procurement of a government license, it had gained only 10 percent equity and no more than dummy status in its polyester staple fibre joint venture with Tuntex. These managers claimed that the Ministry of Finance, which controlled the state-owned companies' purse strings and the Ministry of Industry, which monitored their operations, should have tackled the transnationals more aggressively. But government agencies had not bargained with transnationals.[140] Tuntex, for instance, had brought its firm-specific assets to bear. It had raised fixed and working capital costs to obtain a larger equity stake and higher royalties.

The government struck committees in 1980 to assess the relationship between transnationals and their local partners with regard to capital accumulation and technology transfer. In all cases they found the transnationals, irrespective of origin, unwilling to relinquish majority ownership. But with regard to local partners they found a diversity of conditions. While many companies were unwilling to part with majority shares, many domestic partners were unwilling to buy them. Several local partners argued that they lacked the capital and technical skills to pay for majority ownership, making it difficult for the government to enforce compliance. It had difficulty in determining the cause. Were the domestic partners, imbued with rentier ethic, responsible for their own failures? Or were the transnationals responsible: their unwillingness to transfer technology; to choose the right partners; and the loss-making position of many Japanese subsidiaries since the latter half of the 1970s?

How was the loss-making position of the transnationals to be appraised? A MITI survey showed that 205 foreign subsidiaries of Japanese textile transnationals had liquidated their interest or ceased to operate during the fiscal years 1973-1980; 48 had stopped operations during the years 1982-1983.[141] Bankers who had examined the financial statements of Japanese affiliates in Indonesia had concluded that one-third had faced losses. In Indonesia, the Toray group, with 5 affiliates employing 4,500 workers, recorded a cumulative loss of approximately 10 million in 1982 and had suffered from the March 1983 devaluation.[142] 6 Japanese affiliates had withdrawn between 1983-1985.[143]

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[140] Corporate executive, State/Japanese joint venture, Bandung, 17 August 1987.

[141] Asian Business, 15 May 1984.

An Indonesian textile consultant observed that domestic partners could not obtain majority equity because it conflicted with the transnationals' global strategies. They preferred to hire Japanese rather than local managers in top management positions. The transnationals charged their subsidiaries up to 10 percent of their gross earnings for certain trademarks. Their debt/equity ratios were high.[144] Subsidiaries had to pay interests on loans. Increased costs reduced profits and the domestic shareholder's profit share.[145]

Unequal equity division imposes several constraints on the subsidiary. Bound by non-disclosure and non-competition agreements, subsidiaries could only access information that was essential for the joint venture's operation. But the parent company had free access to the subsidiaries' technical innovations. Most joint ventures had been established as turnkey projects. This prevented the subsidiaries from participating in plant construction and gaining that expertise. Agreements limited subsidiaries to use trademarks domestically and for a specified variety of finished products.[146]

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[142] Nippon Keizai Shimbun (Economic Journal of Japan), 29 April 1983, cited in Toshihiko Kinoshita, "Indonesian Economy Now and Foreseeable Future: Possible Response of Japanese Firms," EXIM Bank of Japan, April 1985.

[143] Toshihiko Kinoshita, "Indonesian Economy," 5.

[144] See Jusuf Panglaykim, "Some Notes on Japan-Indonesian Business Relations: An Indonesian View," Indonesian Quarterly 1 (July 1973), esp.36-50.

[145] Ibid., 45-46.

P.T. Primatexaco was the only Japanese/Indonesian joint venture in which Indonesian and Japanese technicians obtained equal salaries and had an equal voice in management decisions because the equity share of GKBI, the Indonesian joint venture partner, roughly equalled that of its Japanese counterpart.[147] Even The Nien King had been unable to participate in management decisions, such as the hiring of Japanese personnel in P.T. Kumafibre, a practice he deplored. But by the late 1980s the government began to establish the institutional structure to ensure that technology and equity was transferred to domestic joint-venture partners. In February 1988, Kartasasmita asserted that the Japanese transnationals had been unwilling to transfer technology and that the government was installing specific institutional structures to ensure that technology was transferred. The BKPM began to maintain a date bank of reliable domestic partners so that foreign investors could no longer hide behind the excuse that their partners were unreliable and incompetent.[148]

Several scholars have observed that it is not always in the global interests of transnationals to charge their subsidiaries high transfer prices. But Japanese transnationals clearly subordinated their joint ventures' profitability to their global concerns.

The net effect of high transfer prices is to subordinate the profitability of the host country subsidiary to the global profitability of the parent firm. This in turn reduces the local partner's share of profits and the host government's taxes. While parent companies seek to maximise their profits and the benefits they can obtain from the subsidiary, the subsidiary is expected to repay the parent company for all costs incurred. The rationale is that all profit-oriented companies will charge a fee for the services they provide. These costs are variable and allow for transfer pricing since there is no market measure to determine what the service charge should be.[149] Where the majority of a business unit's transactions involve arm's-length dealings with unrelated parties, the market prices at which these transactions take place provide a reasonably reliable basis for equitable pricing of incidental transfers. Where there are few or no arm's-length dealings or where such dealings involve distinct differences in function between the affiliated buyer(seller) and arm's length buyers(sellers), market prices, even if available, tend to lose their credibility.[150] Indonesian joint ventures reimbursed their foreign parents for training services, technical knowledge, and experts at transfer-prices.[151]

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[146] See for instance P.T. Sandang's technical service agreement with Kanebo and P.T. Tuntex's agreements with its parent company, Tuntex.

[147] High-ranking government lawyer, interview by author, Jakarta, 10 March 1987.

[148] The Jakarta Post, 15 February 1988.

The middle-level manager of a Japanese/public-sector joint venture noted that transfer pricing prevailed in the industry to varying degrees: "It is highest in the fibre industry where it is difficult to determine raw materials' prices. In cotton, transfer pricing can be checked if company executives are alert enough to track futures market prices. But there is some potential for transfer pricing since the subsidiaries' managers do not have information about the actual futures price at which the cotton was bought."[152]

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[149] The existence of independent consultants and arm's-length buying does provide some relief if monitoring agencies are adequately established. For a full discussion of the transfer pricing mechanism see Alan M. Rugman and Lorraine Eden, Multinationals and Transfer Pricing (London: Croom Helm, 1985).

[150] G. David Quirin, "Fiscal Transfer Pricing: Accounting For Reality," in Multinationals and Transfer Pricing ed. Alan M. Rugman and Lorraine Eden (London: Croom Helm, 1985), 133-134.

[151] See for instance P.T. Sandang's technical service agreement with Kanebo and P.T. Tuntex's agreements with its parent company, Tuntex.

Conclusion

This chapter shows that in industries where technology is standardised and the host country or local capital can utilise competition or the open market to obtain technology, finance, and marketing expertise, transnationals are all the more dependent on government-created market imperfections to retain their market power. When there is a movement towards workable competition generated by state directives then it becomes more difficult for transnationals to extract oligopolistic rents from their operations. Since they have few bargaining resources, transnationals try to turn the host country's economic nationalist concerns and priorities to their advantage. But even this resource may not serve them in the long run. That is, they may not always successfully neutralise the host state's bargaining advantages when its orientations change.

The Indonesian state's treatment of the polyester fibre producers follows the description of natural resource bargaining described by Moran. Over time foreign investors become dispensable once state enterprises and/or local capital can replace them. It is true that the state could not hold the polyester fibre producer Kuraray hostage. But it had made no attempt to do so. Bargaining was no longer viable.

Gereffi, Newfarmer, Jenkins, Evans, Bennette and Sharpe argue that host governments often have difficulty increasing their bargaining power with transnationals because of the alliances that they forge with fractions of the domestic capitalist class. In this chapter I have shown that indeed domestic and foreign capital were allied, but in two fragments. When the capitalist class is fragmented and when the two fragments are involved in a head-on battle with each other, then the state can emerge as referee as opposed to a weak bargaining contestant involved in a battle with unified local and foreign capital. In this chapter, there is evidence of the replay of capitalist rivalry within the state apparatus. In the face of a changing constellation of class alliances and the shifting power of rival fractions of the capitalist class, there were winners and losers within the state apparatus. Ginandjar Kartasamita had to accept defeat in this instance. Rachmat Saleh lost his ministerial position as a result of this confrontation.

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[152] Corporate executive, Japanese/state-owned joint venture, interview by author, Bandung, 17 July 1987.

In the long term interests of private capital accumulation, the state decided not to burden private domestic and foreign capitalists with its non-pecuniary, political goals. The state was forced to relinquish its hope that private industry would subsidise local cotton growers. The joint alliance between domestic and foreign capital proved too strong for the state to resist.

But this chapter also demonstrates that the final outcome of this battle was settled to accord with the state's changing orientations. In his characteristic non neo-classical economist's style, Moran comments that in industries where firms can play host governments against one another, the "activist host wins out. States which misconstrue and wait passively for markets to work on their own, lose."[153] It is this matter that I address in the next chapter.

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[153] Theodore H. Moran, "The Impact of TRIMS on Trade and Development," Transnational Corporations 1 (February 1992), 58.

Chapter 12

Tryst With the Global Market Via Transnational Linkages

This chapter details the changing strategies that the Indonesian state, transnationals, and local firms adopted to make the transition to export-oriented industrialisation. The chapter describes the inadequacies of existing import-substitution oriented industrial facilities to meet the demands of the export market. It identifies the changing structure of the international textile market and Indonesia's existing and potential position in the global textile market. The chapter demonstrates that to remain competitive domestic firms had to establish alliances with transnationals even if these often took the form of non-equity linkages. The final section of the chapter demonstrates that it is difficult for the state to regulate the foot-loose apparel industry and to derive the bulk of the revenues from it. A conclusion is that while the changing structural changes in the global market have enhanced the power of transnationals, states will continue to regulate them and to bargain with them. Further, Third World states will continue to improve their position in the global capitalist system in a state of dependency.

Section I

> We are not going to use robots in 15-20 years. So we should focus on the garment sector. It has the greatest potential to generate employment and value-added. To backup this development it is necessary to develop backward linkages. We should not worry about labour-intensity upstream. Our prime concern should be to achieve efficiency and to produce high-quality products at competitive prices. If we concentrate on labour-intensity upstream, then the raw materials for garment production will be

less sophisticated.[1]

This assertion by a state-owned company executive captures the essence of the policy framework of bargaining between foreign investors and the government in the mid-1980s. By 1974 the first tell-tale signs of market saturation were beginning to surface. And foreign investors were vexed with their own lack of foresight. Even their estimates of demand for plain grey cloth had gone awry. They had not accommodated poverty, the passage of clothing from older to younger siblings, relatives, and friends, the nakedness of young island children, the temperate climate. They had drawn their assumptions of textile consumption from the affluent societies of Japan, Europe, and the U.S.A.[2]

Although Pelita II had acknowledged the importance of exporting non-oil products as early as 1974, the government had provided luke-warm support to textile exporters. Then domestic market saturation had been the prime moving force. As early as 1974, the large domestic and foreign firms had begun to export their surpluses to Europe, the U.S.A., and the Middle East. But they could not expect export-promotion incentives from the government.

The relative bargaining power of transnationals in a host country depends on the strategic importance of their industry to the host government. With oil prices sky-rocketing in the 1973-1974 period, the textile transnationals could hardly expect to be noticed. The challenge to the oil majors, those giants bestriding the world economy, had chilled the corporate world. It was the time for sitting still or retreating, not for making new demands on host governments that were just realising the magnitude of their power. Despite market saturation, these textile transnationals, the integrated yarn and fabric producers, had been unable to effect major changes in the Indonesian government's policy as long as its policy objective was import-substitution industrialisation, and its major revenue earning industry, oil, was generating massive revenues. This was short-sighted policy, a characteristic of a petro-dollar driven economy.

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[1] Wibowo Moerdoko, Technical Director, P.T. Industri Sandang I, interview by author, Jakarta, 20 February 1987.

[2] "The consumption of textiles in Indonesia equals that of 20 million people in an industrialised country. Whereas per capita annual textile consumption in Japan and in the U.S.A. is 20 kg and 17 kg respectively, in Indonesia consumption is only 2.3 kg." President, Japanese transnational, interview by author, Jakarta, 22 December 1986.

Oil prices, which began to slide in 1983 and crashed in 1986, the product of global pressures in the oil industry, forced the government to give prominence to non-oil exports in which textiles featured greatly. By the early 1980s, Indonesia had completed its "easy" phase of import-substitution industrialisation. "Industrial deepening" was the new government watchword. The domestic textile market was still saturated. But the "easy" phase of import substitution had not served as a platform for the export-oriented forays of garment producers. They had to depend on imports.

Consequently, foreign investors whose initial involvement in Indonesia's textile industry had been to satisfy the domestic market in the "easy" phase of import-substitution industrialisation were given less importance. In quality and price their production runs were uncompetitive for garment exports. While import-substitution and domestic capital accumulation had been achieved successfully, the industry had not accomplished the competitive edge required to change gears to provide the high-quality fabrics necessary for garment exports.

The export market became divided into two segments. One segment consisted of the export of "hard" standardised textiles that had been the basis of Indonesia's import-substitution drive. These exporters consisted of Indonesia's foreign investors and large domestic conglomerates. The other segment consisted of garments produced from imported "soft", speciality fabrics. Fundamental structural changes in the domestic textile industry were essential to achieve a successful export strategy. This was because the international textile industry had changed significantly.

Section II

It is prudent to provide an over-view of these changes since they influenced the policy strategies and concerns that came to the bargaining table in negotiations between foreign companies and the Indonesian government in the 1980s.[3]

> If you look at the pattern of the textile industry in Europe it becomes evident that Germany and Italy which are the largest exporters in Europe tend to have small units with the ability to produce flexible products while Britain and France have continued to produce textiles from mass production units.[4]

The 1960s and the 1970s were the decades in which the industrialised countries' textile industries pursued adjustment strategies to combat the competitive environments of their local and international markets. Combined with an earnest industrial strategy and intense research and development, protection enabled the textile industries of Italy, Switzerland, the Netherlands, West Germany, and Japan to achieve international competitiveness. The "orderly market arrangements" beginning with the Lancashire Pact of 1959, the Long-term Arrangement Regarding International Trade in Cotton Textiles of 1962, and the subsequent Multi-Fibre Arrangements beginning in 1974, provided the breathing space that such industrial restructuring necessitated. The industry became global in scope and it included national industries at different stages of growth, maturity, and decline.[5]

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[3] For good discussions of the changes in the international textile industry see Brian Toyne et al The Global Textile Industry (London: George Allen and Unwin, 1984). See also The Textile Institute, World Textiles: Investment, Innovation, Invention (Manchester: The Textile Institute, 1985).

[4] High-ranking government official, interview by author, Jakarta, 24 March 1987.

Competition from cheap imports had forced corporations in the industrialised countries to re-structure. As Singapore Business reported in 1978:

> The most prominent reason that Japan's textile industry cannot break out of its recession is its loss of international competitiveness. Japan's textile industry is caught between the Southeast Asian countries and the United States, and cannot free itself.[6]

It was protection that enabled industrialised country firms to retrench themselves, a process in which mergers, rationalisations, worker lay-offs and the employment of electronically controlled processes and robotics became common. "Consequently, these governments supported their industries' shift from the production of undifferentiated fabrics, encouraged offshore manufacture of apparel and/or direct foreign investments, and facilitated the transfer of apparel and textile workers to other growth industries."[7]

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[5] Toyne, Global Textile Industry, 180.

[6] "Textiles in Stitches," Singapore Business, August 1978, 41. The oil shock had made Japanese synthetic fibres 20-25 percent more expensive than United States production. For the first half of fiscal year 1977 Japan's seven leading textile companies and nine leading spinning companies recorded a deficit of 36 billion yen and the ratio of profits to sales was -2.4 percent. Ibid.

To raise market prices Japanese cotton and wool spinners formed domestic cartels in April 1977 and reduced production by 30 percent. Japan's Ministry of International Trade and Industry instructed firms to lower operating costs by 20 percent.[8] And it was protection in the industrialised countries that forced corporations in the newly industrialising countries to become more fiercely competitive as their markets in the industrialised countries were constricted.

This industrial restructuring led to the division of the international marketplace into two distinct markets: one was high-priced, differentiated, and post-fordist; the other was low-priced, standardised, and fordist. In the industrialised countries firms sought to challenge the comparative advantage of the industrialising countries with product differentiation and up-grading and with labor-saving devices such as automation.[9] Micro-electronics and robotics featured greatly.[10] In the 1970s, the Swiss and West German industry produced shuttle-less looms and modern open-ended spindles to achieve greater efficiency and productivity. Open-ended spindles were faster, they could be controlled electronically, and they almost completely eliminated yarn breakage.[11]

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[7] Toyne, Global Textile Industry, 169.

[8] Ibid.

[9] Firms introduced high operating speeds for ring-frame machines, open-ended spinning machines, and automatic transfer between individual operators in spinning. In weaving conventional shuttle looms were improved and shuttle-less looms of various varieties including water- and air-jet looms and lepia looms were introduced. The water-jet looms were suited to the production of large lots of undifferentiated products. The lepia looms allowed frequent changes in size and design to meet the demand for differentiated products. Knitting improvements included quicker production and computer-controlled patterns changes. In the apparel industry sewing operations were automated through computer-controlled designing, laser beam cutting, high speed sewing machines and special machines for operations such as button-holing, patch pocket hemming, and decorative stitching. Ippei Yamazawa, "Renewal of the Textile Industry in Developed Countries and World Textile Trade," Hitotsubishi Journal of Economics 24 (1983), 25-41.

[10] Kurt Hoffman and Howard Rush, "Micro-Electronics, Industry and the Third World," Futures 12 (August 1980), 289; Kurt Hoffman and Howard Rush, Micro-

In the industrialised countries the industry also became more capital-intensive. As a 1981 OECD report noted:

> Data on physical capital per employee suggest that, at least in the industrialised countries, the textile industry has by now reached the average capital intensity for manufacturing as a whole. The more rapid rise in the gross capital stock per employee in textiles than in manufacturing is the result not only of the fast decline in employment, but also of the fact that closures and scrapping were concentrated on the least capital-intensive parts of the industry. It is quite likely that the rise in the relative capital intensity of textiles will continue as the old capital stock is replaced.[12]

This post-fordist market specialised in differentiated yarns and fabrics. It was dominated by firms seeking to control specific sectors in a select market. It required product flexibility, versatility, and the development of new fibres and fabrics. It involved considerable market research to adapt to changing end-use requirements. Vertically-integrated ties with textile machinery manufacturers and synthetic fibre producers and end-markets were essential to adapt quickly to changing market requirements. Economies of scale were not an asset. Differentiated fabrics required shorter and more varied production runs in smaller mills. Advances in technology were essential to achieve

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Electronics and Clothing: The Impact of Technical Change on a Global Industry (New York: Preager, 1988).

[11] Corporate executive, state-owned company, interview by author, Jakarta, 19 January 1987.

[12] OECD, Structural Problems and Policies Relating to the OECD Textile and Clothing Industries (Paris: OECD, 1981), 102.

product diversity and flexibility which in turn required heavy investments.

The strategic response of Italian, West German, Taiwanese, and Japanese firms was to target the post-fordist market to maintain international competitiveness. They achieved competitiveness with the support of their governments which recognised that the low-wage industrialising countries had a comparative advantage in producing low-priced, high-volume apparel and textile fabrics. In this process the Japanese sogo shosha helped Japanese textile firms to expand and diversify their markets and they provided the impetus for a stronger marketing orientation. They served as catalysts in the development of new fibres, fabrics, apparel, and textile machinery and were directly involved in marketing textile machinery, textiles, and apparel.

The second market was for undifferentiated or standardised yarns and fabrics aimed at an equally undifferentiated mass market. In this market two strategies were pursued. Large firms from Japan, Taiwan, and Hong Kong moved aggressively into the international market to capture market share in their previous export markets in industrialising countries that were now seeking to pursue import-substitution industrialisation. Or without bothering to establish overseas plants, industrialised country corporations merely, as in the case of the British company Tootal, signed long-term buyers' agreements with domestic producers in industrialising countries, such as Indonesia's P.T. Adetex, to fulfill their requirements for standardised fabrics and yarns.[13] Here they combined standardised production technologies with low-wage labour in highly protected import-substituting markets.

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[13] Corporate executive, textile firm, interview by author, Bandung, 15 July 1987.

In the undifferentiated market, economies of scale were important. Firms tended to be large, relatively inflexible, and dependent on large-volume orders. They were relatively unresponsive to market changes. Producing standardised products over long periods, these firms did not require backward and forward integration with textile machinery manufacturers, synthetic fibre and apparel producers.

The large Japanese corporations such as Toray and Kanebo, that went multinational exported their undifferentiated production base to low-wage countries while restructuring the industry at home. They became internationally competitive while prolonging the life-cycles of their undifferentiated technologies in markets where the populace was content with modest garb. Here they could bring their second-hand and relatively unsophisticated machinery for which they had no use at home. Intra-group trade in fibres, yarns, and apparel was extensive to minimise manufacturing costs, and or to gain access to markets that imposed restrictions on Japanese firms.[14]

Section III

It was the pursuit of an exclusively undifferentiated strategy that made the Indonesian textile industry uncompetitive in the international market when it began to gear itself for the export market in the late 1970s and early 1980s. Indonesian factories had concentrated on producing 65/35 polyester/cotton fabric for which demand had fallen since in North American and Europe, "there is a tendency to reduce the consumption of products that generate (chlorofluorocarbons) CFC's."[15]

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[14] Toyne, Global Textile Industry, 156; Ken'ichi Yasumuro, "The Contribution of the Sogo Shosha to the Multinationalization of Japanese Industrial Enterprises in Historical Perspective," in Overseas Business Activities ed. Akio Okochi and Tadakatsu Inoue, Series no.9 (Tokyo: University of Tokyo Press, 1984), 78-83.

The garment industry's dependence on imports caused Indonesians to complain that Japanese, Taiwanese, Hong Kong, and Indian foreign transnationals did not transfer technology, that they only provided the minimum training required to run the Indonesian joint venture.[16] Why had they not restructured on time? In 1987 the independent Swiss-based consulting agency Gherzi observed that while in export markets there was an increased demand for soft, finer fabrics in Indonesia, "a large proportion of manufacturers are only able to produce hard fabrics."[17] Textile experts agreed that many local fabrics and yarns were not exportable.[18] They also warned that the Indonesian industry would have to achieve greater efficiency and lower its costs to compete effectively with Hong Kong, Korea, and Taiwan.[19] Now foreign and domestic investors alike were forced to retrench their production styles and capacity to become internationally competitive.

The contradictions of the undifferentiated strategy pursued during the easy phase of import-substitution are captured in the words of Sandang I's technical director, Wibowo Moerdoko:

> Exactly in 1980 when the international industry took a radical turn and there were radical changes in textile chemistry and textile machinery, we purchased brand new ring-spinning machines. We had acquired brand new

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[15] Corporate executive, state-owned firm, P.T. Industri Sandang I, interview by author, Jakarta, 22 January 1987.

[16] Textile consultant, interview by author, Jakarta, 4 February 1987.

[17] Peat, Marwick & Mitchell, "A Market Survey," 204.

[18] Textile consultant, interview by author, Jakarta, 4 February 1987.

[19] Peat, Marwick & Mitchell, "A Market Survey," 204.

> obsolete technology. We are now saddled with Japanese machinery when the Europeans have advanced beyond the Japanese in textile technology. They have replaced ring-spinning machines with rotor-spindles. We thought that Japanese machinery producers - Toyodo and Nissan - would never fail us. We were wrong.[20]

By the mid-1980s, industrial restructuring in the textile industry became a paramount objective for Indonesian policy makers.[21] The government commissioned various studies to ascertain the textile industry's requirements during this new age. The World Bank completed a report on the textile industry in 1987 promising $400 million to aid the restructuring process. In 1986-1987 the Gherzi consultants conducted a detailed analysis for the Directorate General of Multifarious Industries, pinpointing the areas requiring restructuring and the strategies to be pursued to make the industry more competitive.[22]

Scholars such as Bennette and Sharpe and Gereffi have noted that in the manufacturing sector the state's bargaining power is at its height when foreign investors enter the market.[23] This argument is based on the location-specific advantages that host governments derive from holding the keys to entry. Over time the host government's bargaining power does not increase with respect to foreign investors in the manufacturing sector because of two factors - manufacturing firms tend to forge close links with domestic entrepreneurs and there are continued innovations in technology.[24]

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[20] Wibowo Moerdoko, Technical Director, P.T. Industri Sandang I, interview by author, Jakarta, 20 February 1987.

[21] See for instance, The Jakarta Post, 2 December 1987.

[22] Two textile consultants, interviews by author, Jakarta, 11 March 1987.

[23] Gari Gereffi, "The Renegotiation of Dependency and the Limits of State Autonomy in Mexico (1975-1982)," in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. Theodore H. Moran (Lexington, Mass.: Lexington Books, D.C. Heath and Company, 1985), 100. Also see Douglas Benette and Kenneth Sharpe, Transnational Corporations Versus the State: The Political Economy of the Mexican Auto Industry (Princeton: Princeton University Press, 1985), 88-89.

These views of bargaining represent what Moran calls static notions of the "balance of power" model.[25] Location-specific advantages can be nullified by the firm's ownership-specific advantages - control over technical and marketing expertise and its control over capital, often important considerations for host governments. The alliance between domestic and foreign capitalists definitely reduces the areas of conflict between foreign investors and the state because in the manufacturing sector the state's bargains are often struck on behalf of domestic capitalists. Technical innovations are not the preserve of manufacturing firms. Natural resource firms also make technical innovations that enable them to achieve favourable swings in the balance of power, although the swings may be less precipitous over the long-term.[26]

Moran's model allows for swings in the balance of power at different historical junctures between foreign investors and the state. At each new commitment by foreign investors, the bargaining strength of foreign investors is at its peak. The shifts in bargaining power, from foreign investor to host government, are repeated before and after each new major corporate commitment.[27] But this does not mean that the host government has to retreat to the ground on which it had stood in the first encounter.[28]

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[24] Gereffi, "Renegotiation of Dependency," 100.

[25] Theodore H. Moran, Multinationals and the Politics of Dependence: Copper in Chile (Princeton: Princeton University Press, 1974), 158-159.

[26] Ibid., 167-168.

[27] Ibid.

[28] The period under study only allows an analysis of the bargaining conditions surrounding the period when these new concessions were granted. It remains to be

Unlike the year 1967, in the 1980s the Indonesian government did not grant foreign investors a blank cheque. It hinged its new incentives on a variety of conditions. In this round the government was backed by a strong capitalist class which was also a strong constituency demanding attention.

In the bargaining school literature it is argued that the convergence of interests between foreign capital and the state should not be analysed from the regressive dependency perspective as simply an alliance between the state and foreign capital in which the state merely succumbs to the pressures of the capitalist class. The interests of the two parties must be analysed to determine if the convergence derives from similar or disparate interests.[29] It is also necessary to identify those objective interests in a historical-structural context.[30] As in 1967, there was a convergence of interests between foreign investors and the state. In 1967 the state and foreign investors had agreed to pursue import-substitution industrialisation; in the 1980s they agreed to pursue export-oriented industrialisation.

Convergence on broad policy does not imply convergence of interests between foreign investors and the host government on the components of broad policy. Convergence does not imply that the state is held captive by foreign investors, that it is a passive actor. But it is certainly less autonomous when a whole host of domestic and foreign interests demand changes in its policy necessary for its capital accumulation

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seen whether in the next century the government will introduce new restrictions on foreign investors when domestic capital has developed the capacity to continue the export-oriented drive on its own.

[29] Benette and Sharpe, Mexican Auto Industry, 81-84.

[30] Ibid., esp. chap.4.

goals.

> The apparent ability of the state to control and direct national capital and even increase its bargaining position with respect to foreign capital raises the question of state autonomy - the freedom of the state from direct and indirect control by the dominant classes and ultimately from structural constraints. The importance of state autonomy revolves around the question: to what extent or under what conditions can the capitalist state operate independently of class intervention and pressures - particularly those of the dominant class - and itself become a protagonist in the making of history?[31]

The government's encounter with foreign investors in the 1980s differed from the 1967 round despite a convergence of interests between foreign investors and the government. The two parties differed about how the export-oriented strategy was to be conducted and what incentives were necessary to make it successful. The state only encouraged dependency relations in areas where domestic firms lacked the skills and/or capital to replicate the functions of foreign firms or trading houses. The state gave incentives grudgingly, piecemeal, almost as if it was testing the limits to determine when the incentives to achieve the export-oriented drive would be sufficient.

In this encounter, the transnationals' power still lay in ownership-specific advantages as had been the case in 1967. Firms had capital that the state was unwilling to borrow. They had marketing expertise and knowledge of how to bring about the qualitative requirements of buying markets. The government's bargaining power derived from location-specific advantages: its comparative advantage, its access to unused quotas in industrialised countries. It also derived from the existence of a strong domestic capitalist class. The state also gained strength from its capacity to restrict foreign investment to areas of its own choosing, sectors that it had targeted for exports. Foreign firms entering unrestricted investment areas were obliged to make their export programs successful. Otherwise, they would not have access to government incentives.

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[31] Ibid., 305.

It could be asserted that in an industry such as textiles, where technical innovations are inherent in the machinery, production methods are standardised, and where technical consultants and experts can be hired easily, states and local entrepreneurs do not have to be held hostage by foreign firms. Then why did the Indonesian state make concessions to the textile transnationals in the 1980s? I argue that the state wanted to derive the benefits from the marketing knowledge that foreign investors had accumulated over the past two decades. In Gerschenkronian tradition,[32] it wanted domestic capitalists to climb the learning curve, to learn the techniques to capture export markets more quickly than would have been possible through pure trial and error.[33] The replication of the foreign investor's marketing and technical skills by domestic entrepreneurs would be hastened rather than prolonged. These were determining factors in the state's decision to renew its commitment to foreign investment.

The state also wanted a balanced budget. Compared to the 1960s and early 1970s, the parameters of bargaining since the second oil shock had definitely narrowed from the viewpoint of host countries and multinationals.[34] "Governments do not wish to undermine the position of foreign investors which would jeopardise the thin stream of inflows."[35] The non-oil producing countries had become more tolerant of foreign investors since the second oil shock. By contrast, as was demonstrated in the last chapter, during that period, oil-producing countries such as Indonesia had strengthened their position with the non-oil transnationals since the state could use its windfall profits to further some of its goals without the assistance of transnationals.

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[32] Alexander Gerschenkron, Economic Backwardness in Historical Perspective (Cambridge, Mass.: Belknap Press, 1962), 7.

[33] See statement by Junior Minister of Trade, Ariwobo in The Indonesian Observor, 11 May 1988.

[34] Richard Newfarmer, "Multinationals and Marketplace Magic," in The Multinational Corporation in the 1980s Charles P. Kindleberger and David B. Audretsch (Cambridge, Mass: Cambridge, 1984), 184.

But in the period following the oil price slump, the Indonesian government chose the strategy that Newfarmer says applies to most revenue-short countries: governments prefer equity rather than debt as a source of capital.[36] It was in this vein that in January 1986 Massaaki Horiguchi, the EXIM Bank of Japan representative in Jakarta, wrote, "The Indonesian government is not willing to increase its external borrowings but it would be pleased to receive foreign capital. The government has already extended export finance to the joint venture companies to promote non/oil and gas commodities exports. Foreign investment is to be encouraged in the export industries."[37]

Indeed, the September 1986 devaluation had been the decisive factor for the parent companies of many textile joint ventures to adopt an export-oriented drive. "Since we pay our loans in foreign exchange, we are forced to earn our profits in foreign exchange as well. Since September 1986 we exported 50 percent of our yarn and 100 percent of our machine embroidered fabric."[38] This was a common refrain.[39]

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[35] Ibid., 185.

[36] Ibid., 184.

[37] Masaaki Horiguchi, "Finance to Indonesia and the Export-Import Bank of Japan," EXIM Bank of Japan, Jakarta Office, January 1986.

Thus the government achieved its desired objective. It had forced firms that were struggling to survive on domestic market sales, to change their orientation and perspective. They too had longed for this change in perspective. But with this change in perspective, the government was forced to provide export-oriented firms with the means to become internationally competitive. The government had adopted a brand new strategy, export-orientation, for which foreign investors demanded brand new incentives.

This time around there was no anti-foreign tirade. The enemies were within the body politic itself against whom an economic nationalist vituperation served little purpose. It was fear of the gigantic conglomerates and monopolies of Indonesian origin that gripped the body politic. Suffocated by the swelling and corrupt smog of syndicates that threatened to envelop them, smaller companies preferred to breathe the sparser winds of free trade at their own peril.[40] In this they were joined by export-oriented foreign firms and leading Indonesian economists, international institutions and foreign governments. Such support for free trade was unprecedented in Indonesian history.

Seasoned foreign investors in the Indonesian economy set the tone for the new incentives that would be granted. Their laments rent the skies, forewarning newcomers from venturing forth unless there were changes in government policy. This prevented the government from adopting the well-used post-war bargaining ploy of playing new investors against the old. But with world-wide globalisation, collapsing barriers, and deregulation in the mid-1980s, it was not the season for such indulgence.

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[38] Corporate executive, Indian transnational, interview by author, Bandung, 7 August 1987.

[39] This was the most popular explanation given for a movement towards the export market.

[40] This was a recurring theme in Indonesia's national dailies during the mid and late 1980s. Also see for instance, Adam Schwarz, "Call for Constraints," Far Eastern Economic Review 28 December 1989, 55.

Foreign investors touted Thailand as a more hospitable investment environment. Depending on their specific experiences, the textile transnationals were most offended by one or the other of the following factors. They complained about inadequate access to the swap facility, state bank credits, the high costs of raw materials that came from high tariff and non-tariff barriers, the existence of the sole agent to whom they had to impart 25-30 percent of their profits, and the three devaluations of 1978, 1983, 1986.[41]

As discussed in the last chapter, they would no longer brook non-tariff and tariff barriers in importing their raw materials for the export-oriented drive. They sought depreciation allowances and import duty exemptions to bring in new German and Swiss machinery to expand their facilities. They complained about the discriminatory nature of the Export Certificate(Sertificat Export) of 1983, a subsidy program for export-oriented firms which gave domestic firms access to low interest financing for 85 percent of their exports whereas foreign firms had to settle for 75 percent.[42] Japanese investors complained about the Indonesian government's local content requirements, its erratic policies, unstable monetary conditions, and discrimination against foreign companies.[43] Reporting for Business Japan, Michinari Ozawa noted:

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[41] Interviews: B. Arunachalam, P.T. Kewalaram Indonesia, Bandung, 18 July 1987; Bushan G. Daryani, Indo-Rama Synthetics, Jakarta, 18 December 1986; N.S. Dorhailay, P.T. Five Star Textiles Ltd,. Bandung, 18 July 1987; P. Radhakrishnan, P.T. Five Star Industries Ltd., Bandung, 17 July 1987; P.N. Ojha, P.T. Ganga Suci Silk Industries, Bandung, 19 July 1987; T. Kashiwabara, President Director, P.T. Mermaid Textile Industry, Jakarta, 22 December 1986; Y. Kaneda, Director, Sales/Purchasing Department, P.T. Mermaid Textile Industry Indonesia, Jakarta, 22 December 1986; K.K. Agarwal, President Director, P.T. Sunrise Bumi Textiles, Jakarta, 27 July 1987; N.K. Sharda, Vice-President, P.T. Sunrise Bumi Textiles, 6 August 1987; Surya S. Anand, Senior Vice-president, P.T. Sunrise Bumi Textiles, Bandung, 7 August 1987; Hiroshi Oshima, Director, Japan External Trade Organisation, Jakarta, 14 May 1987; Tsuguo Ogasawara, Finance Director, P.T. Indonesia Toray Synthetics, Jakarta, 7 February 1987; Mr Srinivasan, President, Texmaco, Jakarta, 17 May 1987; Deepak Bhattasali, The World Bank, Resident Staff in Indonesia, Jakarta, 18 April 1987; Jayant Basrur, P.T. Kewalram Indonesia, Bandung, 3 August 1987; Andre Mambo, P.T. Unilon Textile Industries, Bandung, 4 August 1987; Yasuo Kodama, Director and General Manager of Business Department, P.T. Indonesian Synthetic Textile Mills, Jakarta, 19 February 1987; Chikage Shibata, President, PT Teijin Indonesia Fiber Corporation, Jakarta; Hiroaki Okubo, President Director, PT Century Textile Industry, 22 December 1986.

> In order to expand Japan's direct investments in Indonesia, improvements are awaited in various fields such as the adjustment of infrastructure, flexible implementation of the assimilation of Japanese capital in the local economy, relaxation of work-permit and long-term visa regulations, and the correction and proper execution of related laws and regulations.[44]

The Japanese government asked the Indonesian state to provide an attractive climate for foreign investors. On 29 April 1987, Toshiak Muto, the Japanese ambassador to Indonesia, reminded the Indonesian government of Japan's contribution to the country, of the 200 Japanese joint ventures nestling in Indonesia, bestowing U.S.$5 billion in cumulative investments and 10 percent of Japan's total investments.[45] A spokesperson for the Japanese embassy in Indonesia warned that while Japanese investors would not abandon Indonesia, some had suffered losses and others would terminate their activities.[46]

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[42] Ibid.

[43] Mohammad Sadli, "Can Japan help Indonesia to Get Out of the Recession," Kompas 14 October 1986.

[44] Michinari Ozawa, "Mutual Dependency Marks Indo-Japanese Trade Relations," Business Japan 29 October 1984, 40.

[45] Suara Karya, 29 April 1987.

Leading Indonesian economists favoured deregulation.[47] The former Minister of Mines and Energy and former BKPM Chairman Mohammad Sadli admonished the state for not taking adequate steps to encourage Japanese investors and for acknowledging the pivotal role that Japanese sogo shosha could play in Indonesia's non-oil export drive.[48] One of them, Sanjojo, who represented the prestigious consulting firm, P.T. Data Consult, argued that since the state's budgetary constraints prevented it from exerting an expansionary impact on the economy, state intervention had to give way to private capital accumulation.[49]

The World Bank consistently prodded the government for reforms.[50] While applauding the government for its sweeping trade reforms, the World Bank noted that it was necessary for the government to dismantle import bans and quotas, foreign investment and licensing restrictions to make Indonesia more attractive to foreign investors.[51]

The general drift towards deregulation can be captured in government policy from 1985-1990. The changes in government policy came gradually in a series of packages.

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[46] Kompas, 12 July 1986.

[47] See for instance, the comments of economists Anwar Nasution, University of Indonesia and Mari Pangestu, daughter of the famed economic nationalist, Jusuf Panglaykim and Priasmoro Prawirohardjo, chief executive of Bank Perkembangan Asia. The Jakarta Post, 23 September 1987.

[48] Mohammad Sadli, "Can Japan Help Indonesia to Get Out of the Recession," Kompas, 14 October 1986.

[49] Indonesian Observor, 12 February 1988.

[50] See the series of reports that the government received from the World Bank from 1983 onwards.

[51] The Jakarta Post, 20 May 1987.

Each package was followed by new complaints. In an opening address to a seminar on the prospects of Indonesian balance of payments for 1988-1990, Junior Finance Minister Sumintapura said that the state aimed to "generate capital accumulation in the non-oil sector which would help to resolve its balance of payments problems and bring surplus to the state."[52] Non-tariff barriers were gradually dismantled to remove import and export restrictions for export-oriented firms and to relax the BKPM's licensing procedures and sectoral limitations that thwarted foreign investment.[53]

A number of foreign investment incentives were announced in the May 6 package. Firms exporting 85 percent of their production could be 95 percent foreign-owned. They could import their raw materials freely.[54] The state gave foreign investors equal access to the swap facility. As a representative of a major transnational bank noted, "If foreign investors have to pay a premium they ought to put it in their cost. That is the price that the government must bear for foreign investment in Indonesia."[55]

The pressures of globalisation were being felt by the foreign investors' home governments as well. They were forced to respond to the demands of domestic capital seeking an outlet. On Ginandjar's request the EXIM Bank of Japan agreed to send a mission of some Japanese medium- and small-scale enterprises to study investment conditions in Indonesia in August-September 1987.[56] It also took measures to ease investment conditions for Japanese investors. In June 1986, the EXIM Bank law was amended so that it could finance Japanese joint ventures directly. But the law still limited them to yen financing which prevented them from reducing foreign exchange risks through hedging. Now, "with the Indonesian government, the EXIM Bank was seeking to finance Japanese joint ventures so they could avoid the foreign exchange and credit risks."[57]

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[52] The Jakarta Post, 26 May 1988.

[53] General Agreement on Tariffs and Trade, Trade Policy Review: Indonesia 1991 (GATT, Geneva: 1991), 55. See also Ginandjar Kartasasmita's March 1987 promise that the government would continue to liberalise licensing procedures. The Jakarta Post, 24 March 1987.

[54] For a detailed discussion of this package see Price Waterhouse, Doing Business in Indonesia: Information Guide, 1986.

[55] Corporate executive, transnational bank, interview by author, Jakarta, 6 May 1987.

The export-oriented drive gave prominence to foreign investors and the large domestic textile groups on both ends of the spectrum. "In the garment industry local producers were encouraged to establish links with fashion houses and other foreign companies. Upstream, high-quality production required the ownership-specific advantages of the larger, more successful firms."[58] In Indonesia the deregulation drive led to the same processes that were being engendered world-wide: like the human health enthusiasts of the 1980s, firms were cutting their fat. They were becoming leaner, stronger, taller, and more muscular as they eliminated their more obese and slow-moving counterparts. "A group system is developing in which the larger companies are becoming conglomerates."[59]

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[56] "Regarding Japan Lending Activities to Indonesia during FY 1986." Memorandum from Masaaki Horiguchi, Chief Representative, The EXIM Bank of Japan, Jakarta Representative Office.

[57] Masaaki Horiguchi, "Finance to Indonesia and the Export-Import Bank of Japan," EXIM Bank of Japan, Jakarta Office, January 1986.

[58] Corporate executive, state-owned firm, interview by author, Jakarta, 22 January 1987.

[59] High-ranking government official, interview by author, Jakarta, 21 March 1987.

These firms, producing the best quality products, were the first to export their products abroad. So when Indonesia became subject to export quotas in various European markets and in North America in the 1980s, these firms were given priority based on the government's criteria of "past performance" which they themselves had helped establish.[60] 90 percent of the garment export quotas were controlled by non-pribumi Indonesians.[61]

Now again, to promote exports, the government gave out expansion permits to foreign and domestic firms so that they could restructure their plants and succeed in the export-oriented drive. Following the German and Italian model, the largest domestic firms began to restructure their plant facilities to cater to the new market demands that the structural changes in the international textile industry had wrought.[62]

As Moran points out, "while pushing for greater value-added locally, host governments are using foreign transnationals as marketing vehicles for channelling products back to the home countries of the transnationals or to third country markets."[63] For the first time, foreign joint ventures could export products produced by other companies, a field previously reserved for Indonesian companies.[64] Having prohibited the sogo shosha from exporting Indonesian products during the late 1970s and early 1980s, now the Indonesian state literally begged them to participate in marketing Indonesian non-oil products, in Japan and other parts of the world.[65]

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[60] Textile consultant, interview by author, Jakarta, 11 March 1987.

[61] President, Indonesian garment manufacturing firm, interview by author, Bandung, 7 August 1987.

[62] President, integrated textile firm, interview by author, Jakarta, 17 July 1987. President, Indian transnational, interview by author, Bandung, 9 August 1987.

[63] T.H. Moran, "Multinational Corporations and the Developing Countries: An Analytical Overview," in Multinational Corporations: The Political Economy of Foreign Direct Investment ed. T. H. Moran (Lexington, Mass.: Lexington Books, D.C. Heath, 1985), 19.

[64] The Indonesian Observor, 26 December 1987.

The needs of local producers, foreign and domestic, to employ the powerful marketing expertise of the Japanese sogo shosha gave the latter a pivotal role in the Indonesian economy. The sogo shosha began to serve as conduits for Indonesian exports to Japan from Korea and Taiwan because the quality conscious Japanese consumer viewed "Made in Indonesia" garments with disdain.[66] The Indonesian state sought the aid of the sogo shosha to break through Japan's tightly controlled distribution networks.[67]

Taiwanese, Hong Kong, and South Korean apparel firms anxiously awaited government policy changes to capitalise on their ownership-specific advantages by exploiting Indonesia's location-specific advantages.[68] Export-oriented firms will turn multinational when they face protectionist barriers in their major export markets. Taiwan, South Korea, and Hong Kong had completely utilised their textile quotas.[69]

Initially, as long as other variables are constant, foreign firms will seek to add the least value to their product on foreign soil. The aim is merely to capture the host country's quota. Later as protectionist tendencies in their export markets become more stringent, from which country of origin rules derive in the case of textiles, firms are forced to transfer their production facilities to other countries to cash in on those quotas.[70] In addition, the host countries' cheaper labour and their comparative advantage are added incentives for direct foreign investment.[71]

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[65] See for instance Ginandjar Kartasasmita's attempts to woo Japanese sogo shosha in The Indonesian Observor, 12 April 1988.

[66] The Jakarta Post, 12 August 1987.

[67] Speech by Wiyogo Almodinoto, Indonesian Ambassador to Japan cited in Kompas, 3 April 1986.

[68] The Indonesia Times, 6 November 1986.

[69] Hoffman and Rush, Micro-Electronics, 209; Jeannette Jarnow and Mirian Guerreiro, Inside the Fashion Business: Text and Readings (New York: Macmillan, 1991), chap. 7.

These apparel-producing foreign investors had initially come to Indonesian territory in the late 1970s merely to label their garments and perhaps to stitch a button or two.[72] Responding to strict country-of-origin rules they sought closer ties with domestic firms. While Ginandjar was tempting investors in South Korea,[73] the Director of Jakarta's Korea Trade Centre, Kim Seung-Tae unabashedly noted that his country's textile producers aimed to take advantage of Indonesia's large quota of textile products in the U.S., the E.E.C., and Canada for which the Indonesian textile industry lacked the expertise and production facilities. These investors, he argued, offered to Indonesia the prospect of job opportunities and in the long term, the exploitation of that country's comparative advantage.[74]

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[70] Jarnow and Guerreiro, Fashion Business, 316.

[71] Hoffman and Rush, Micro-Electronics, 209.

[72] President, Indonesian garment manufacturing firm, interview by author, Bandung, 6 August 1987; Corporate executive, garment manufacturing firm, interview by author, Bandung, 8 August 1987.

[73] The Indonesia Times, 6 November 1986.

[74] Ibid. See also "South Korea Agrees to Increase Investment in Indonesia," The Indonesian Observor, 8 October 1987. By late 1987 there was an increasing discussion of cooperative links between Korean and Indonesian entrepreneurs. The Indonesia-Korea Economic Cooperation Committee of the Indonesian Chamber of Commerce aimed to enhance links between the two sides. The BKPM had established a partner bank system so that foreign investors could find reliable and suitable partners. The Jakarta Post, 7 October 1987. For the plans of South Korean firms

But foreign direct investment, which is the least common form of investment in the global apparel industry, also constituted only a small percentage of investment in the Indonesian garment industry.[75] Domestic firms had autonomy in determining the extent of their dependence and the kinds of linkages they wished to forge with foreign firms. Since the late 1970s, a large number of Hong Kong and Taiwan garment manufacturers had established links with domestic investors - as financiers, as sub-contractors to the large international firm with whom they already had well-established supply arrangements, as suppliers of technology, designs and raw materials and primarily as sources of markets. 80 percent of the non-pribumi firms that controlled the bulk of export-quotas were financially controlled from Hong Kong, Taiwan and Singapore.[76] Firms utilised foreign production managers to achieve quality control and established links with fashion houses in the U.S.A. and in Europe.[77]

The structural nature of the garment industry does not lend itself to state control and regulation. Therefore, the scope for bargaining is limited. The barriers to entry for domestic firms derive from several sources. The two major forms of foreign involvement, international sub-contracting and licensing, are popular and almost indispensable features of the global textile industry. International sub-contracting is

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invest in Indonesia see The Jakarta Post, 30 September 1987.

[75] High-ranking government official, interview by author, Jakarta, 24 March 1987.

[76] Hal Hill, "The Emperor's Clothes Can Now be Made in Indonesia," Bulletin of Indonesian Economic Studies 2 (1991), 5.

[77] President, Indonesian garment manufacturing firm, interview by author, Jakarta, 10 May 1987.

simply a putting-out system on a world scale.[78] It entails almost no transfer of production facilities.

It is a multi-layered grid, often composed of a chain of four producers, with production controlled loosely by an international firm or industrialised country retail chain but with disaggregated ownership of the production facilities.[79] It follows "the logic of 'footloose' industries and 'runaway shops' moving around the globe to exploit changing opportunities."[80] The less industrialising country firm is tied to a vertically-integrated production process and depends on the parent to sell its goods.[81] In various stages work is passed from one sub-contracting firm to the next, from larger to smaller firm, where greater and lesser firms share the surplus unequally.

The foreign firm's ownership-specific advantages reside in brand names, product-differentiated clothing, a strong fashion orientation, flexible adaptation to fashion changes, market control and expertise which includes outlets, publicity, market research, and design.[82] In the clothing industry, technology is transferred through the licensing of brand names and trade marks. Sears, Charles Oman, Levis are examples of firms that allow less industrialising country producers to use their brand names for which they earn exorbitant rents in the form of a license fee topped with a royalty. As a Blue Bell vice-president remarked in 1979,

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[78] Keith Cowling and Roger Sugden, Transnational Monopoly Capitalism (Sussex: Wheatsheaf Books, 1987), 88-89.

[79] United Nations Centre on Transnationals, Transnational Corporations and Technology Transfer: Effects and Policy Issues (New York: United Nations, 1987), 22.

[80] James A. Caporaso, "Labour in the Global Political Economy", in A Changing International Division of Labor ed. James A. Caporaso (Boulder: Lynne Rienner Publishers, 1987), 198. Hoffman and Rush, Micro-Electronics, 189-192; 44-46.

[81] Caporaso, "Global Political Economy," 198.

[82] United Nations Centre on Transnationals, Transnational Corporations in the Man-made Fiber, Textile and Clothing Industries (New York: United Nations, 1987), 22.

> We are after clothes of a standardised design that the masses buy and that can be produced through mechanised assembly and marketed with the Wrangler brand. We have spent $75 million on the Wrangler name, and we are cashing in on that now.[83]

Grunwald and Flamm argue "in apparel the principal barrier to entry has been the frequent and unpredictable changes in fashion and styles."[84] International buying and selling, the establishment of marketing contacts, and advertising were all highly capital-intensive and perhaps, futile efforts for domestic firms. Haute couture set the pace for fashion in the designer and mass-production arenas.[85] Oscar de la Renta, Blue Bell and Lewis had become status symbols. No amount of advertising on the part of an Indonesian firm could change that reality and the hypnotic control that designer names have on the affluent consumer. The costs of making those investments and their attendant risks cancelled out the benefits that domestic and even foreign firms might have gained by performing those functions themselves. Moran notes:

> When advertising and brand identification are important to the commercial success of a venture, foreign MNCs begin in a stronger bargaining position and maintain it longer than when a project's output is sold according to standard specifications. Thus investors fabricating fine household products or cosmetics tend to enjoy more lucrative investment agreements than companies producing bulk textiles or undifferentiated

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[83] Business Week, 12 May 1979.

[84] Joseph Grunwald and Kenneth Flamm, The Global Factory: Foreign Assembly in International Trade (Washington D.C: The Brookings Institution, 1985), 8.

[85] Jarnow and Guerreiro, Fashion Business, chaps. 4 and 8.

office products.[86]

The major designer houses and retail chains control the bulk of the profits from the retail trade. They are the most zealous champions of free trade in North America and Europe, "being able to gain maximum benefit from their large size and bargaining power because they are major buyers from both foreign exporters and domestic clothing firms".[87] While international sub-contracting may steal American and European jobs, it does not deprive the American and European governments of tax revenue. Indeed, the differential between the selling price for the host country manufacturer and the retailer in the industrialised country is so great that both the firm and the importing government or home government receive steep rents.

The host government cannot control or tax the exorbitant rents that accrue to these firms in industrialised country markets: the international sub-contracting firms only generate tax revenues for their own government. This position occupied by the host state in the garment industry is diametrically opposed to its position in the oil industry, where double taxation agreements with host governments prevent home governments from enjoying any tax revenues at the wellhead.

To the smaller and larger garment Indonesian sub-contractors, their insertion into the global market was a godsend.[88] To be a contractor to a large firm producing for the world market represented an assured and until now, inconceivable route to capital accumulation. Their involvement in garment manufacturing had begun in the 1970s. These small manufacturers became involved in garment production with a few in-house domestic sewing machines. These informal establishments operated without contracts, sales inventories, and proper accounting. Now they became more professional, more entrepreneurial,[89] shedding their petit bourgeois complexion.

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[86] Theodore H. Moran, "Multinational Corporations and Third World Investment," in Latin America: Dependency or Interdependence ed. Michael Novak and Michael P. Jackson, (Washington D.C.: American Enterprise for Public Policy Research, 1985), 17.

[87] Hoffman and Rush, Micro-Electronics, 44.

[88] Owner, sub-contracting garment manufacturing concern, interview by author, Bandung, 14 July 1987. High-ranking government official, interview by author,

Now they did not have to worry about working capital because they obtained their supplies from the larger domestic sub-contractors who also gave them design specifications. Instead, they could use their accumulated capital to expand their facilities and pay off their fixed costs. Previously, they had borne the risk alone. They would prepare random samples without information of consumer preferences, entirely dependent on the wholesaler's fancy. Now their risk lay in unsatisfactory production. Unsatisfactory production made the "footloose" nature of the international garment industry a stark reality for the domestic sub-contractor - large or small. But if producers could provide high quality garments at competitive prices they could obtain a fairly secure market niche.[90]

Indonesian garment manufacturers produced a range of qualities. They produced garments for the relatively superior, fashion-conscious, mass-producing companies such as Liz Claiborne and Esprit, and for the lesser mass-production firms and retail chains such as Jacqueline Smith, Arrow, K. Mart, and Lady Manhatten. Small- and medium-

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Jakarta, 27 March 1987.

[89] Ibid.

[90] Ibid.

sized companies served as sub-contractors for the larger domestic firms.[91] Here too there was a dominance of the Chinese firms. Some sole agents, such as P.T. Sinar Sahabat, had established garment manufacturing firms completely financed with foreign capital. It was the firms that had affiliations with foreign companies that had succeeded in breaking into the export market.[92]

The Indonesian state inspired domestic firms to establish ties with international designer houses so that they could maximise value-added and secure assured markets for their products.[93] The putting-out system, based on its system of differential rewards, served the Indonesian state's balance of payments exigencies, its private capital accumulation goals, its penchant to add value to Indonesian exports. For this it was willing to accept dependence and vulnerability to foreign capital. The state's decision-makers understood that the barriers to entry were high and that domestic firms could not overcome them as yet. They wanted domestic firms to climb the learning curve, to capture export markets, achieve higher quality and value-added. Foreign firms would make domestic firms privy to their knowledge - contacts in importing markets where competition was fierce.[94] Domestic firms did not seek regulation. They sought to be free of government encumbrances that thwarted them from producing for the international market, achieving the required quality, suffering losses in market share through needless delays.[95]

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[91] Corporate executive, garment manufacturing firm, interview by author, Jakarta, 16 May 1987; President, garment manufacturing firm, interview by author, Jakarta, 8 May 1987.

[92] Corporate executive, state-owned firm, P.T. Sandang I, interview by author, Jakarta, 27 March 1987.

[93] Drs. Asyik Ali, Expert Staff of the Trade Ministry urged domestic textile firms to establish links with export houses to improve market channels. "Textile Entrepreneurs Urged to Increase Cooperation with Foreign Counterparts," The Indonesian Observor, 5 April 1988.

[94] See statements of Junior Minister of Trade, Ariwobo in Indonesian Observor, 11 May 1988 and Ginandjar Kartasasmita, Indonesian Observor, 13 September 1987.

That the Indonesian state had converged with foreign investors on the export-oriented front, and had refrained from bringing certain issues to the bargaining table did not imply that the state was without leverage with respect to foreign investors. It gave out incentives selectively. Local capital accumulation had occurred. Import-substituting firms for the domestic market were not given incentives. Not only did the state deprive them of protection but it also neutralised their power to earn rents through transfer pricing.

This point was amply demonstrated in the polyester staple fibre case of the previous chapter. If the Japanese PSF producers refused to establish backward linkages, it mattered not to the state. The state found alternative measures to achieve its objectives. With the aid of its state-owned company Pertamina and other foreign investors the state established the backward linkages necessary to produce raw materials for PSF production which it sold at international prices. Thus it rendered redundant the PSF producers' rationalisations for higher domestic PSF prices. Which state manager had understood transfer pricing adequately in the early 1950s? And more importantly, which industrialising country had the wherewithal to neutralise it?

But it is sometimes easier for a state to relinquish its autonomy on one level, such as increasing the role of foreign investors in its economy, than to succumb to other pressures, such as taking a begging bowl to powerful states and international institutions. States must weigh the costs and benefits of the different constraints on policy action and make conscious policy choices.

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[95] President, garment manufacturing firm, interview by author, Bandung, 4 August 1987. Corporate executive, garment manufacturing firm, interview by author, Jakarta, 17 May 1987.

The Indonesian state was constrained by falling oil prices. It had been primarily a free-rider of OPEC's lack of discipline and also a breaker of the system because of its own propensity to cheat. But the outcome of OPEC's disarray and the oil glut of the mid-1980s had forced the state to find other avenues to make money. It could have chosen to borrow and spend huge amounts of money on import-substitution and on prestige projects. It did not. It chose to balance its budget, albeit at the prodding of the World Bank, the I.M.F., and the liberal technocrats.

It was a conscious policy decision that produced a new industrial policy. The new industrial policy aimed at adding value to export products, giving targeted industries special incentives to restructure so that the state could achieve its balance of payments objectives. It was the state's conscious policy which drove the new export-oriented drive. But once a state pursues a particular policy it must make compromises with the major interests that will enable it to achieve its objectives. This may make it more vulnerable in some areas but may reduce its vulnerability in the areas which it considers to be the most sensitive. But all states, even the most powerful empires, kingdoms or states, have been vulnerable to international pressures since the sixteenth century. The state's ultimate concern is: does that stress represent a dent, a crack, or a hole in its hull?

The so called "new international division of labour" does impose constraints on the state's capacities for autonomous action. Since the 1980s globalisation has changed the dominant forms of internationalisation and the role of the dominant actors - states and transnationals. Finance occupies centre-stage in an epoch of mergers, acquisitions and the 'casino economy'.

In the rivalry between transnationals and the state, globalisation tipped the balance in favour of the firms. There were many reasons. The recession played a major role in the reconsideration of Keynesian economic policy. Globalisation prevented states, even states that had in the recent past been the makers of the system, from managing macroeconomic variables. The Mexican debt crisis demonstrated that private off-shore banks could not regulate themselves. The October 1987 financial crash poignantly depicted the failings of unfettered globalisation and the need to reintroduce regulation in stock exchange markets. As the title to Kutner's timely book The End of Laissez Faire: National Purpose and the Global Economy After the Cold War signifies,[96] it was time to "bring the state back in" as Ruschemeyer, Evans, and Skocpol would argue in a different, earlier context.

> What emerges in this increasingly globalised pattern of production is a challenge to the traditional relationship between the economy and the state. The globalised market system stretches beyond the political authority of any single government. Faced with a network of connections that escape their powers of surveillance and regulation, national governments become increasingly unable to cope with the problems that arise from the intrusion of the global economy into their territories ...Worse, the degree of that intrusion is steadily growing, while the defensive capability of the

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[96] Robert Kuttner, The End of Laissez-Faire: National Purpose and the Global Economy After the Cold War (New York: Alfred A. Knopf, 1991).

state remains largely static.[97]

The extent to which states are circumscribed by the global economy increases their sensitivity to those pressures.[98] In Gerschenkronian terms, as a latecomer, Indonesia could shorten the process of learning to capture its export markets by imitating the newly industrialising countries'(NIC's) firms and by accessing their package of ownership-specific advantages - capital, technology and marketing skills. This need became all the more urgent as protectionism grew in the industrialised countries, as they began to restructure their garment manufacturing facilities at home with automation to become more price competitive, and as quotas for ASEAN countries became smaller than they had ever been for the NICs during the "easy phase" of the export trade.[99]

In an export market with few players the NICs had enjoyed the luxury of leisurely learning during the 1960s and 1970s. The ASEAN exporters could ill-afford such extravagance. They had to add value quickly, almost instantaneously. And then too, for the larger part of their export expansion careers the NIC firms had relied principally on international sub-contracting and licensing arrangements with importing firms.[100] It is only in recent years that the NIC garment manufacturing firms have started to acquire shares in some retail and mass-producing garment manufacturing firms in their major import markets.[101] This was the path for the latecomers.

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[97] Robert Heilbroner, Twenty-First Century Capitalism (Concord: Anansi, 1992), 60.

[98] For an excellent discussion of sensitivities and vulnerabilities see John Zysman, "The French State in the International Economy," ed. Between Power and Plenty: The Foreign Economic Policies of Advanced Industrial States in Peter Katzenstein (Wisconsin: Wisconsin University Press, 1978), 255-294.

[99] Hoffman and Rush, Micro-Electronics, 208.

[100] Jeannette and Guerreiro, Fashion Business, 373-376.

The Indonesian government had accumulated the knowledge and skills to grant incentives to foreign investors selectively, hamstrung with conditions. Some issues had already been settled. The issue of equity shareholding was not up for grabs - it would not be discussed or debated.[102] Foreign investors were clear that they could only own 95 percent of the shares in a company if they exported at least 85 percent of their production or if their production was primarily aimed at feeding the export drive. For firms that did not want to increase their shareholding, export orientation became an urgent goal.[103] In the import-substituting areas, 51 percent shareholding or complete divesture would gradually become the norm. When combined with the Daftar Prioritas Skala, these were powerfully restrictive instruments.

National control of equity shares in foreign companies, and domestic marketing and distribution, already controlled by strong entrenched interests, could not be given over entirely to foreign investors. This time around there was a strong domestic coalition of capitalists whose interests could not be ignored. Not only had local capital accumulation occurred but there was a strong constituency favouring the continued movement towards national control. The domestic capitalist class consisted of various fractions. There were the large Chinese conglomerates. And then there were the capitalists whose accumulation was rooted in rent collection. These two class fractions had an influential role on the government's decision-making. To safeguard their interests, the government grudgingly tested the parameters within which old foreign investors would be willing to stay and new ones would come to Indonesia.

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[101] Ibid.
[102] Textile consultant, interview by author, Jakarta, 15 December 1986.
[103] Ibid.

A host of issues depend on national control of equity shares. Local capital accumulation depends on the amount of surplus that domestic firms can derive through their collaboration with transnationals. Profit remittances, transfer prices, royalties, reinvestment in diversification, backward integration, and even the division of export markets determine how the surplus between periphery and centre will be divided.[104]

That the state now gave foreign investors the right to distribute their own products domestically and access to state bank credits were not mighty concessions.[105] The state had for the first time decreed and directly intervened to force the equity share issue. Indeed, there had been nothing to prevent foreign investors from maintaining a grip over their shares for the full ten years, and longer, if the government and the domestic partners chose to keep the issue off the bargaining table.

Now the two major concessions were conditional upon divesture, of a magnitude that the government had not envisaged or demanded before. Firms would have to relinquish 75 percent of their shares to an Indonesian partner or 51 percent on the stock market. The latter was obviously the less-threatening solution to the foreign investor. For stockholders of common stocks do not and cannot challenge or control the foreign investor's managerial style, strategic planning, or profit-making schemes. They cannot determine their percentage share of dividends. And they cannot threaten the foreign investor with takeover. While maintaining complete control, the foreign investor can judiciously argue that it only has minority control over the company, a satisfactory mask for the less observant economic nationalist.

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[104] Peter Evans, Dependent Development, 194-195.

[105] For a brief discussion of the May 6 package see Hal Hill, Foreign Investment and Industrialisation in Indonesia (Singapore: Oxford University Press, 1988), 32-33.

The size of the international firm creates entry barriers at the industry level. It also "acts as a powerful source of monopolistic advantage on its own by providing privileged access to capital markets, to information, to production factors, and to government favours."[106] By inviting small- and medium-sized companies to enter Indonesia, the Indonesian state sought to reduce the impact of large foreign companies in the economy and to create a competitive and level playing field for the large domestic and foreign firms. The state gave preference to investors from the NICs to reduce Japanese dominance on Indonesian economic policy.[107]

Protectionism in the U.S., Canada, and the E.E.C. worked to enhance the Indonesian government's bargaining power in various ways, concerned as the technocrats were with budgetary constraints. By forcing firms to add greater value in Indonesia, protectionism had forced foreign firms to re-locate their facilities or at least give domestic workers and producers a greater share of the pie. If they learned their lessons well, domestic firms could look forward to the prospect of capturing the quotas themselves.

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[106] Sanjaya Lall, "The Theoretical Background," in The New Multinationals: The Spread of Third World Enterprises ed. Sanjaya Lall, Edward Chen, Jorge Katz, Bernando Kosacoss, and Annibal Villela (Chichester, John Wiley & Sons, 1983), 2.

[107] Indonesian Observor, 12 May 1988.

In 1985 the U.S. Department of Commerce concluded that Indonesian textile exporters were being subsidised. An Indonesian government official wrathfully noted that the Indonesian government had initially not even been informed that the U.S. Department of Commerce was investigating Indonesian firms on Indonesian territory. "They just went to the different private firms and investigated them without our permission."[108]

> The American government forced us to overturn the subsidy, warning us that they would close the quota. They sent a team to determine our cost of production and demanded that we should raise the prices at which we sold our textile exports to the United States. They set floor prices for imports and warned that if we did not comply, they would not import our textile products. A quota is not free trade.[109]

Although government officials grumbled about foreign interference when they signed the bilateral agreement with the U.S. government in 1985 and the GATT code on Countervailing Duties and Subsidies in 1986, and called the investigation by the U.S. Department of Commerce an affront to Indonesian sovereignty,[110] protection in the U.S. did empower the Indonesian government to reduce the subsidies that it gave out to foreign and domestic firms. Protectionism added value to the government's bargaining power because one of its objectives was to add value to its export products. The GATT Code enabled the government to phase out the 9 percent interest rate on export credits in 1990.[111] Government officials themselves admitted that local companies had been forced to improve quality and achieve higher value-added.[112]

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[108] High-ranking government official, interview by author, Jakarta, 24 March 1987.

[109] Former high-ranking government official, interview with author, Jakarta, 19 March 1987.

[110] High-ranking government official, interview by author, Jakarta, 8 March 1987.

[111] GATT, "Gatt Policy Review: Indonesia," 24.

Until the late 1970s, the government had secured the transnationals profitability by protecting them even against their domestic counterparts. Now the companies were responsible for their own well-being in a non-discriminatory environment in which they were dominant. Now the government only had to give them the special incentives that domestic firms enjoyed for the export-oriented drive. Thus, in 1986, the government gave foreign companies equal access to the swap facility where previously they only had access to 75 percent. They also had equal access to the export credit facility.[113]

The movement towards an export-oriented drive that favoured massive imports was not an unmitigated defeat for Ginandjar and other leading economic nationalists. It was a short-term measure to enable the economy and the industry to shift gears from import-substitution to exports. Self-reliance was not abandoned. It was postponed. A compromise was found in the restructuring process. There was a recognition that if Indonesian manufacturing firms, domestic and foreign investors alike, gave too much importance to the downstream sector, it would keep the country dependent raw and intermediate materials' imports.[114]

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[112] Deepak Bhattasali, The World Bank, Resident Staff in Indonesia, interview with author, Jakarta, May 6 1987.

[113] High-ranking Maasaki Horiguchi, Chief Representative, EXIM Bank of Japan Representative Office, interview with author, Jakarta, 25 August 1987.

[114] See for instance, Minister Hartarto's statement that the textile industry's dependence on imports was decreasing and that the government would continue to take measures in that direction. He also emphasised that the PTA plant at Dumai would begin producing PTA at a capacity of 150,000 tons a year to be increased to 225,000 tons in 1988. The Indonesian Observor, 2 December 1987. Junior Minister of Industry, Tungky Ariwobo emphasised that Indonesia should export more finished products and reduce imports of raw materials. He also stressed that the government

Rationalising the industry itself implied that the government seriously sought to establish the infrastructure to "deepen" import-substitution industrialisation aimed at feeding the export-oriented drive. Eventually local content requirements would naturally culminate from this process and would require bargaining. To this end the state was willing to allow foreign capital and large conglomerates to enjoy centre-stage in leading the reordering process. This time around the difference was that local capital shared in the prominence. It was no longer subordinate. Large Indonesian conglomerates were revamping their plants and facilities as rapidly as their foreign counterparts. They would co-exist and compete for a share of the export market.

Conclusion

Local firms may eventually displace foreign firms. The government will demand that foreign investors add value locally for the export drive. Domestic groups will not be deterred from demanding complete control over exports when they have the capacity to achieve it. This is the stuff that host governments bargain for in the manufacturing sector.[115] Once local capital has been able to replicate the functions of the foreign firm in the export-oriented drive then there will be no need for the state to bargain with foreign capital in the textile industry. Then the bargains will be struck internally, among state, local capital, and labour.

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would give incentives to foreign firms that supplied products to downstream plants. The Jakarta Post, 6 June 1988. In February 1988 Ginandjar Kartasasmita emphasised that the government would continue to protect domestic products. The Indonesian Observor, 6 February 1988. Earlier, he had complained that the Indonesian manufacturing industry was biased in favour of the downstream industries. The Jakarta Post, 23 March 1987.

[115] Moran, "Multinational Corporations," 19.

There is already a movement towards indirect control in the garment industry. The Indonesian state encouraged dependency relations in areas where domestic firms lacked the skills and/or capital to replicate the functions of foreign firms or trading houses. But it also encouraged "new forms of investment."[116] There is a whole debate on this issue. The phrase illustrates the host of contractual alternatives for foreign direct investment - licensing, franchising, turnkey contracts, production-sharing and management contracts through which industrialising countries seek to access the transnationals' inputs, technology, management and markets, while avoiding the political costs of foreign direct investment. "Rather than obtaining the inputs in a bundle and giving residual value of the venture to the foreign investors, the FDI solution, the "new forms" solution, consists in leaving the residual in local hands, and in purchasing the needed inputs from foreigners in contract."[117] Some scholars see the trend towards these new forms inevitable, and applaud them for providing a solution to the conflicts between transnationals and host countries.[118]

The Indonesian state encouraged domestic firms to de-couple the transnationals' ownership-specific advantages - technology, marketing expertise, and capital.[119] This was possible in the textile industry where many of the larger Indonesian firms were already restructuring their plants without foreign equity participation. They bought the machinery from the large European firms, hired consultants, and raised the capital via state and off-shore banks. They could compete effectively on international markets with the aid of the sogo shosha or other trading companies. They did not need transnational equity participation.[120]

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[116] Two government bureaucrats, interview by author, Jakarta, 1 and 2 July 1987.

[117] Jean-Francois Hennart, "The Transaction Cost Theory," in The Nature of the Transnational Firm ed. Christos N. Pitelist and Roger Sugden,(London:Routledge, 1991), 103.

[118] Oman, New Forms.

[119] Two government bureaucrats, interview by author, Jakarta, 1 and 2 July 1987.

Viewed from the perspective of the international firm, international subcontracting has reduced the power of host governments to regulate them.[121] But subcontracting satisfies the economic nationalist criteria better than foreign direct investment. The domestic entrepreneur has greater autonomy and is able to partake directly in the production process. As the Gherzi consultants argued, "there is a distinct advantage for privately owned companies which, with the right organisation will be able to increase the feasibility of their projects without reference to multinationals."[122] The domestic entrepreneur will have to carry the risks and burdens of financing the operation and of not satisfying the qualitative requirements imposed by the international firm. This local entrepreneur is definitely less secure.

But the domestic entrepreneur's risks and costs are considerably reduced by maintaining dependent linkages with firms in buying markets. It is those firms that determine what is and will be haute couture. They expend huge advertising and designing budgets for rapidly changing fashions, an unreachable goal for the local entrepreneur in the less industrialising country. Fashion may represent superficial vanity with little spiritual and humanitarian value. But affluence and hedonism, those human states that promote the fashion industry in the industrialised and industrialising world and exploitation and automation for garment workers, are the subjects of another study.

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[120] Ibid.

[121] Kurt Hoffman and Howard Rush, Micro-Electronics and Clothing: The Impact of Technical Change On a Global Industry (New York: Preager, 1988), 46.

[122] Gherzi Report to the Ministry of Industry, Government of Indonesia, September-October 1986, 127.

Conclusion

In the last twenty-odd years much solid research has emerged to analyse host country-foreign investor relations. Third World states are no longer seen as passive recipients of the fate that transnationals, pursuing their global profit-maximising logic, deign to bestow upon them. Recent in-depth, industry-specific case studies have provided a solid and varied collection of conclusions about the relative autonomy of host states in their interactions with transnationals. This study confirms and adds new insights to the existing body of literature on transnational-host country relations.

In their modern form, transnationals have been with us for a century. They have played a dominant role in Third World countries. It is the transnationals' operations in these countries that have contributed to much of our understanding of the logic of capital accumulation on a global scale. Transnationals are the central agencies commanding and organising production in international and national markets. Their control over finance, technology, and markets makes them significant structures of power.

Transnationals are political entities. They influence how economic goods will be distributed within national boundaries. Their refusal to participate in a capitalist state's accumulation project acts as a significant constraint on state autonomy. In a capitalist state where transnationals participate in production, much bureaucratic activity occurs around the creation of laws and regulations to enable or curb their activities. To the extent that transnationals seek to persuade state decision-makers to make policy that favours them, and to thwart state policy that favours less privileged and less powerful entities, political economists and political scientists must contend with transnationals and their political influence.

Politics often intervenes to prevent host governments, local firms, and transnationals from transforming their power resources into favourable outcomes. Host governments, their civil societies and capital - domestic and foreign - are not monolithic. As I have shown in this study, there was fragmentation within the Indonesian state apparatus and transnationals did try to steer policy in their favour. These fragmented agents have different, changing, and often contradictory orientations which also vary across and within industries. This fragmentation within the state apparatus was discussed in chapters 4, 6, 7, and 8 for the oil industry. The state's use of inter-capitalist rivalry as a power resource was discussed in chapter 4. Inter-capitalist rivalry and alliances in the textile industry were the subject of chapter 11. Here, too, state agencies were divided about the best approach to adopt with respect to transnationals. Here the state could emerge as a relatively autonomous referee and direct policy in favour of those transnationals with which its interests coincided most closely.

As I have shown in chapter 6, the state's reduced ability to achieve desired outcomes was the product of its continued dependence on transnationals for their firm-specific assets, the technocrats' desire to pay too low a supply price for those assets, and the state's inability to utilise the moment of transition in 1974. Aden's conclusion that excessive concentration of power adversely affected the bargaining position of the Indonesian state after 1976 appears misplaced. Rather, fragmentation within the state apparatus prevented the translation of state power into desired outcome.

If the state pursued uniform policies towards transnationals, and transnationals across the spectrum of industries pursued similar strategies and had access to equal resources and levels of power, it would be a futile exercise to conduct a detailed two-industry study. But as this study demonstrates, while all firms are governed by the logic of profit maximisation and they derive their bargaining strength from the three broadly defined firm-specific assets - capital, technology, and markets - there are important industry-specific features that distinguish state action and transnational influence on the policy formation process. Transnationals do not have access to similar power resources and the timing at which they can exert their power varies across industries.

Studies dealing with the relations between transnationals and the dependent Third World state in manufacturing industries have concentrated on high-technology, oligopolistic manufacturing industries. The collection of essays in Richard Newfarmer's volume Profits, Progress, and Poverty is a good illustration. It is argued that in such industries host states find it difficult to increase their autonomy and to erode the transnationals' firm-specific assets. But Moran has contended that it was not high- or low-technology but its dynamism that is the critical factor determining the extent to which the state and local firms can raise their autonomy with respect to transnationals. These contentions have been tested in the Indonesian case.

On a comparative basis, it is possible to contrast state strategies and to present the state as a diverse collection of agencies with several faces. In and of itself, a two-industry study enables the analyst to show that the state is not monolithic. It provides the tools to demonstrate that across a wide range of industries transnationals have access to different levels of power and resources at different historical junctures, depending upon the changing position of the industry over time; the changing position of local capital and the evolving objectives of state agencies.

The year 1967 brings into sharp relief this contrast in Indonesian state policy discussed in chapter 4 and 10. The Indonesian state was simultaneously relatively autonomous and regressively dependent. The state's relevant agencies were persuaded that it was wise to provide non-oil transnationals with an uncompetitive protected environment combining high tariff and non-tariff barriers so that they could capture oligopolistic rents to prolong the life-cycle of their product. But in the oil industry, Sutowo persuaded Suharto to utilise competition to drive a harder bargain with incumbent transnationals, against the judgment of Bratanata and the oil majors who wished for the status quo.

At this point, it would be well to emphasise that politics matters: fragmentation within the state apparatus brought about this diverse policy and fragmentation need not weaken the state. Indeed, diverse perspectives of the national interest may strengthen the state in its bargaining encounters with transnationals. If Bratanata's will had prevailed I would be recounting a different story here, a story in which state policy differed little across industries, and perhaps, of a comprador state that had failed to utilise a moment of transition to change the balance of power in its favour. It is the two-industry study method that makes such comparisons possible.

The historical development of new institutions and agencies gives the state the ability to bargain with transnationals. A central conclusion of this study is that host governments and local entrepreneurs do have the capacity, if combined with the political will and a correct reading of opportunity, to increase their autonomy from transnationals and to erode their firm-specific advantages. But this capacity develops over time. And, it is in industries where technology is relatively stable, domestic firms are well-developed with the financial capacity and marketing expertise to replace transnationals, technology is non-patented and easily available on the open market that the local firms and states are most triumphant. They face the greatest barriers to entry in industries where the converse it true.

In this study I have shown that in the Indonesian oil industry the state's autonomy increased over time within the limits of its dependency situation. It is the regressive dependency perspective that most clearly explained the independent Indonesian state's relationship with the textile transnationals from the late 1960s to the late 1970s. In upstream oil production this period lasted from 1949 to 1963. But by the late 1980s, the Indonesian state had not emerged triumphant over transnationals, rendering them useless to the Indonesian oil production process, the ultimate conclusion of the bargaining "balance of power" model, because of its specific objectives and its continued dependence on the transnationals' firm-specific assets. While it bargains, the Indonesian state remains dependent.

When petroleum technology was relatively standardised in the late 1960s and early 1970s, the emergence of independents enabled host states to pay a lower supply price to transnationals. The changing structure of the industry and the international environment provided this opportunity. But the oil-producing transnationals' ability to remain at the technological edge with more dynamic and sophisticated technology gave them the resources to extract a higher supply price from the host state and to hold it hostage, as I have shown in chapter 7. The conclusion: the capitalist state cannot and will not endanger its long-term capital accumulation goals by entering into an all-out battle with transnationals. In the late 1980s, the Indonesian state continued a benign bargain with transnationals from a position of strength with added knowledge but in a state of partial dependency.

In the production of standardised textiles the bargaining balance of power model as applied to extractive industries fits the Indonesian case. The state and local firms started their relationship with foreign firms on very unequal terms but over time their bargaining power increased. By the late 1970s the state was utilising inter-capitalist rivalry to encourage domestic participation in the hitherto oligopolistic market controlled by transnationals and it was dismantling the protective barriers that it had once accorded to them out of fear and a perception of weakness, and a regressive dependency position. Here we see local firms beginning to reach the bargaining peak with the capacity to replace transnationals.

Here the difference between manufacturing and extractive industries becomes evident. When the state utilises competition in a natural resource industry, it can renege on the original bargain in the hope that hostage transnationals will concede better terms. Further, normally with a well-developed state enterprise in an extractive industry, the state is itself more in control of the bargaining encounter. In a manufacturing industry, for the state to adopt a strong bargaining position with respect to transnationals, strong public sector or private firms are essential power resources. In an industry where local private capital will primarily fill in for transnationals, the state can only take the risk of introducing competition when a domestic entrepreneurial class has developed. In essence, the state must await its emergence. Further, in a manufacturing industry, transnationals are mobile. They can only be held hostage when they retain firm-specific assets from which they can derive oligopolistic rents in a new competitive environment. But in an industry where transnationals derive oligopolistic rents from tariff and non-tariff protection alone, they prefer to divest.

In the oil supply and service sector and in the garment sector, transnationals exercise greater bargaining leverage which they derive from technological dynamism and relative mobility. In both industries there is evidence of greater integration between foreign and local capital and of non-equity forms of foreign participation, for several reasons: many local firms do not require the financial resources of their transnational counterparts; transnationals can derive oligopolistic rents through sub-contracting and licensing arrangements without the attendant risks and costs of equity ownership. The state's regulatory role is reduced in such industries. There is less evidence of bargaining as domestic and foreign allies turned outwards, seek international competitiveness through cooperation. The alliances that foreign and local capital forge prevent the state from pursuing a nationalist agenda in the early stages of the development of such industries. Over time, however, this study expects that in both these industries which had short life-spans during the period of this study, local firms will climb the learning curve and they will be in a position to pay a lower supply price to transnationals for their services.

States and transnationals utilise various strategies to counter each other's bargaining resources. In this study I have shown that state and corporate learning is an ongoing process. As the state learns to utilise its resources - its sovereign power and its location-specific assets transnationals produce alternative tools or turn state demands to their advantage to neutralise those resources. They employ joint ventures, non-equity participation, even economic nationalism, and their traditional firm-specific assets to undermine the host state's bargaining power during its moments of strength. In manufacturing industries, local firms and transnationals do form alliances which often prevents the state from adopting a tough bargaining position with respect to transnationals. In natural resource industries, transnationals are unable to employ this option. But even counter-strategies can have a limited life-span. As Chapter 11 shows, transnationals sought but failed to utilise economic nationalism to their advantage. Their joint-venture partners were gearing to break away became their rivals in the market.

A comparative analysis of host country-foreign investor relations in the manufacturing and extractive sectors in Indonesia suggests that it is not the time of entry of transnationals that differentiates the bargaining leverage that manufacturing and natural resource transnationals exercise. Instead, it is the transnationals' ability to perpetuate or enhance the value of their firm-specific assets that gives transnationals their bargaining leverage over domestic firms and host states. Once their firm-specific assets have been eroded, the major difference between natural resource and manufacturing firms is their relative mobility. The institutions that the state creates to erode the transnationals' firm-specific assets and the strategic importance that a state attributes to a particular industry will have a significant impact on the extent to which local firms and host states will triumph over transnationals. This becomes evident in comparing the Indonesian state's strategies towards textile transnationals in the pre-1979 and the post-1979 period. In the oil industry, which always occupied the "commanding heights" of the Indonesian economy, this situation has prevailed throughout the Indonesian state's interactions with transnationals.

This study concludes that the capitalist state will not take measures against transnationals that undermine its long-term capital accumulation prospects. Instead, the state will choose partial dependency, provide transnationals with selective incentives to accord with its changing orientations, and when feasible, will bargain with transnationals from a position of strength.

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